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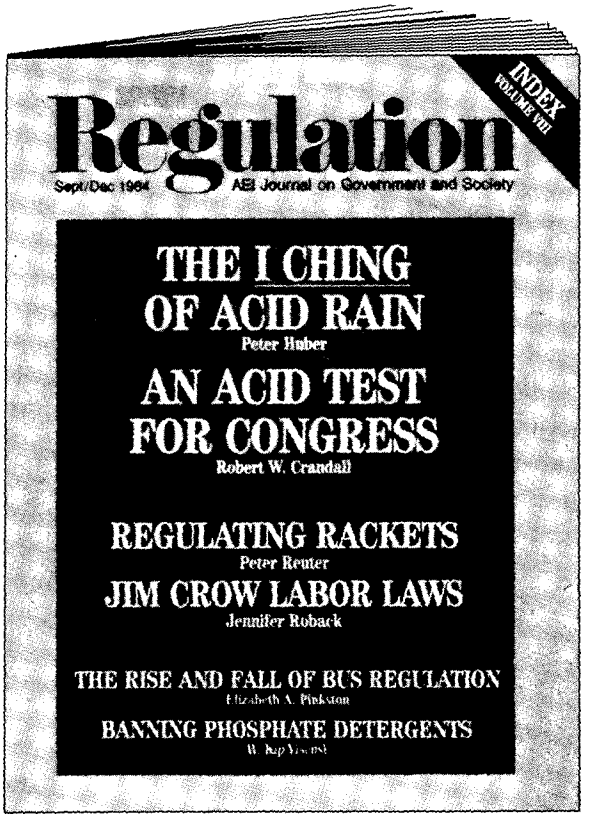

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Regulation

Jan/Feb 1985 AEI Journal on Government and Society

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Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Sagebrush Roundup

TO THE EDITOR:

Robert H. Nelson has demonstrated once again his ability to write about public land management with outstanding clarity, incisiveness, and relevance ("Why the Sagebrush Rebellion Burned Out," *Regulation*, May/June 1984, and "The Subsidized Sagebrush: Why the Privatization Movement Failed," July/August 1984). It is heartening to see serious scholars examining the problems and opportunities of the federal lands.

His account of why the inept privatization proposals of the past four years failed so completely is informative and perceptive, as is his description of how privatization of public lands is nonetheless occurring incrementally.... I do not challenge his conclusions, but I would like to add a few further points.

First, the privatization of federal lands was proceeding at an appreciable pace before the Taylor Grazing Act was passed in 1934. In the decade before 1934, Washington disposed of at least a million and a half acres every year, and as much as 5 million acres in 1925—even though federal laws were not well designed for such disposal. I find it hard to believe that all private sector interest in acquiring federal land has ended since then.

Second, the impetus for privatization must come from the purchasers, not the government agencies. The junk that federal agencies are willing to dispose of is, with few exceptions, junk no buyer would want. If we are serious about privatization, we must be prepared to let private parties (including conservation groups) acquire land truly valuable to them.

Third, again if we are serious about privatization, we must expect it to take some time. The fire-sale approach of the past four years was doomed to failure simply because it sought large results too quickly. If what we want is to pretend to privatization but not really achieve it, then by all means we should let the federal agencies designate what they do not want and try to sell that quickly.

Finally, the disposal of much federal land on any terms—including outright gifts to present users—would improve the net income position of the U.S. government. The government's present costs of administration far outrun its income from the lands.

Marion Clawson,
Resources for the Future

TO THE EDITOR:

Nelson argues that special interest groups were cool to President Reagan's privatization proposal because they feared that it would not serve their interests. While Nelson's argument has merit, it is incomplete. It fails to explain why the general public likewise fails to support private ownership of the nation's vast federal estate.

To see why this is so, we must understand the role that ideology has played in corrupting science, which, in turn, has been used to deceive the public. In the context of the public lands debate, which goes back a long way, this deception began in the late nineteenth century.

The American Economic Association (AEA) was founded in 1885 as a way of lending scientific and professional credibility to its founders' ideological opposition to the laissez-faire English and Austrian schools of economics. Its leadership used land ownership as an object lesson toward this end. In 1890, for example, the AEA held a joint meeting with the American Forestry Association to promote public ownership of forest lands. The keynote addresses were presented by three distinguished foresters (E. A. Bowers, B. E. Fernow, and Gifford Pinchot) and appeared in the May 1891 issues of the *American Economic Review*. Although veiled in the language of science, these papers amounted to little more than ideological, socialist bluster.

The conferees at the AEA-AFA meeting were told that timber resources must be wards of the state because trees require long periods to mature. Private individuals would not invest in this crop, it was argued, because they would not live long enough to reap the fruits of their investments. To support this nonsensical argument—which, by the way, was accepted by the general public—the ideologues of public ownership pointed to the extensive clear-cutting, without replanting, that was occurring on private lands.

What the early advocates of public ownership failed to take into account was that the nation's then-abundant supply of mature timber made it economically desirable to draw down the inventory for a time. By making this inventory adjustment, the logging industry was simply converting low- into high-yielding assets.

The ideologues of public ownership continue to hide behind the veil of science. Now they tell us—in the words of James Watt, former secretary of the interior and an ardent foe of privatization—that if land is sold to private owners "a sheep pasture will become an industrial site [and] desert lands will be used for hotels and resorts." What they fail to tell us is that private lands currently produce, at the same time, more valuable commercial *and* environmental outputs than comparable public lands. Privatization need not require a trade-off between commercial and environmental outputs; private ownership typically generates more of both.

So long as the public ownership advocates can cloak their ideological arguments in scientific objectivity, public opinion will continue to support retention of federal lands. Once the cloak is removed, however, the way will be prepared for the nation to complete the unfinished task of privatizing its lands.

Steve H. Hanke,
Johns Hopkins University

TO THE EDITOR:

Nelson describes well the events that led to the demise of recent attempts to privatize federal lands. He traces the concept from its ori-

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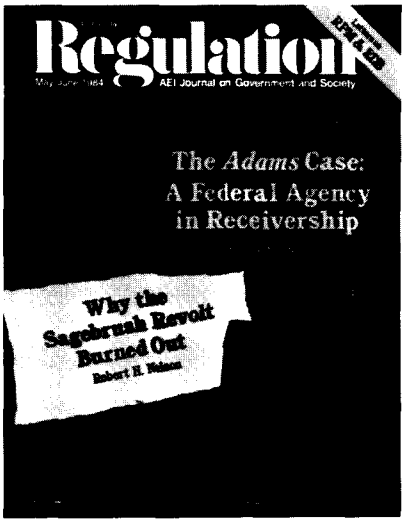
gin among a small group of academic economists to its attempted implementation during James Watt's reign as secretary of the interior, an attempt that led to a stampede to the public trough by subsidized interests. By the time state and federal land bureaucrats, subsidized ranchers, and various recreationists finished with the privatization idea, its advocates in the administration were either employed elsewhere or suddenly terribly busy with other pressing matters. Watt formally buried the whole idea in the summer of 1983.

In attempting to explain these events in terms of resource allocation, politics, and history, Nelson struggles to keep a complex subject simple. Noting the vast literature indicting federal land ownership with gross inefficiency, Nelson fails to mention potential market failures that many believe would result from privatizing many western lands. Unique areas, such as the national parks, are presumably unique because there are no substitutes for them. Privatizing these kinds of lands would create private, as opposed to public, monopolies. Owners could restrict entry and set user charges well above costs—resulting in a different type of economic inefficiency than that linked to public ownership.

Another assortment of market failures involves externalities, intergenerational allocations, option values, and irreversibilities. Regardless of one's view of "non-market" values in general, these issues represent real political as well as conceptual problems for privatization advocates. For example, public opinion polls, for what they are worth, have generally shown Americans to be skeptical about selling federal lands in the West. When a 1983 ABC/*Washington Post* Poll asked people if they favored selling national forest lands, the responses were 11 percent yes, 58 percent no, and 31 percent no comment. I am unaware of any documented opinion surveys to the contrary.

There are several problems with Nelson's conclusion that privatization will not occur until the intellectual base established for it in recent years "can be translated into an acceptable popular ideology." First, that intellectual base remains incomplete because of its weaknesses in addressing market failure problems. Nelson complains that the opponents of privatization place the burden of proof on the proponents, but it seems fair to expect the positive case for privatization to consist of more than microeconomic theory and ideological fervor. Second, the idea that there could be a "popular ideology" in favor of privatization seems unrealistic. The widespread perception that privatization would result in equitable wealth transfers from the public domain to various upper-income groups is a serious political problem.

It seems wrong to conclude, as Nelson does, that privatization will either succeed or be viewed as a "footnote" in the history of the West. Privatization has already had a significant impact, by spurring public land bureaucracies to improve their economic performance. While scientific and economic management of public lands has failed in the past, time seems to be on its side. Given expanding public deficits and the information explosion, public land bureaucracies will in the long run respond to the pressure to operate economically. Unless privatization advocates show some heretofore undemonstrated political abilities, this effect of their movement is likely to remain the major one.



For the proponents of privatization, this outcome has to be depressing. If they are to reconstitute the movement, they must accomplish several major tasks soon. The first is to make the positive case for privatization; proponents are dreaming if they think that free-market rhetoric is enough of an intellectual base. The second is to show the average American how he will be better off if the public lands are sold—which is no trivial task, and one that privatizers have yet to begin.

In the end, one has to feel that privatizers' laissez-faire attitude is their greatest weakness. If the implementation of privatization is ever to become something more than a subject for academic treatises on the American West, proponents will have to demonstrate considerably more political common sense than they demonstrated during the early 1980s.

Zach Willey,
Environmental Defense Fund

TO THE EDITOR:

Although Nelson succeeds in capturing the reasons for the abrupt collapse of the Reagan administration's privatization program, I have two main differences with his article. The first has to do with the relative weight he assigns to various explanatory factors. The second has to do with what was, in my estimation, the mistaken focus of the administration's western lands policy.

Two competing laments regularly arise in the perpetual debate over the condition and future of the federal estate. One refrain comes from Sagebrush Rebel types and other westerners. They claim that western land users are forced to conform to federal wishes because federal land ownership is not only overwhelming but so intermingled with state and private holdings as to influence their use significantly. The advocates of this position have systematically underestimated the influence of western politicians and user groups on federal land policy.

The contrapuntal claim, made by some eastern members of Congress, is that westerners are the free riders of the open range, subsidized by the nation in activities ranging from ranching to river running. The advocates of this position consistently undervalue the influence of groups outside the West, from New England environmentalists to energy corporations.

It is no surprise that the Department of the Interior and the Forest Service do not make money. They are not and never have been seen in this country as the equivalent of the giant state energy corporations of Europe such as Electricité de France. The American land agencies are instead the products of often conflicting congressional mandates, competing user constituencies, and the initiatives of their respective bureaucracies.

The principal problem with the privatization initiative was not that private ownership of western lands is a pipedream. It was, rather, that the administration failed to understand the significance of the com-

(Continues on page 63)

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Perspectives
on current developments

Is Conrail Finally on the Right Track?

The dramatic economic recovery of Conrail has been hailed in some quarters as an example of the success of government enterprise. "It speaks volumes about American capitalism that the government may be the most trustworthy entrepreneur to run a railroad," writes Bob Kuttner in *New Republic*. Unfortunately for this theory, Conrail started to revive only four years ago when Congress largely freed it from political restraints—freed it, that is, to behave more like a business and less like a government agency. Now, with Conrail about to be sold to the private sector, the question is whether Congress will remember its experience—or will again invoke the "public interest" to guarantee its favorite lobbies a piece of the action.

Back when Congress established Conrail in the Regional Rail Reorganization Act of 1973 ("3R Act"), many people argued that it was inherently impossible to provide northeastern rail service at a profit. Conrail's components (the Penn Central, the Erie Lackawanna, Reading, Central of New Jersey, Lehigh Valley, Lehigh & Hudson River, and Ann Arbor railroads) were bankrupt and continuing to lose money fast. The only solution seemed to be a government bailout—which, in the fashion of that time, was centralized, expensive, and open-ended. To be sure, some charged that Penn Central represented not "the downfall of free enterprise railroading," in Kuttner's phrase, but the failure of overregulation—specifically, the ICC's prohibition and restrictions on branch line closings, rate hikes, and labor force reductions. But Congress was in no mood to listen to these arguments when it passed the 3R Act.

In an ordinary bankruptcy reorganization, the survivability of the emerging debtor is a prime consideration. Not so in the 3R Act, which was less a business proposition than a political grab bag. The law allowed Conrail to abandon many unprofitable lines, but forced it to keep many others; it made statutory the lifetime employment guarantees that the parties to the Pennsylvania/New York Central merger had agreed to have the Interstate Commerce Commission impose on them; it gave most of Conrail's other workers so much protection that it became cheaper for Conrail to keep unnecessary employees on the payroll than to lay them off; and it forced Conrail to continue money-losing commuter operations. Four years later, in the Railroad Revitalization and Regulatory Reform Act of 1976, Congress gave the railroad industry some limited rate freedom; but the effect on industry profits was not major until three years later.

To nobody's surprise, Conrail proceeded to lose money. By 1980 it had swallowed another $3 billion in direct federal funding, on top of the $3 billion that had been spent to compensate the creditors of the bankrupt companies for the railroad's assets. Worst of all, there was no end in sight. In December 1980 the United States Railway Association, a government corporation set up to fund and monitor Conrail, reported to Congress that, under the prevailing restrictions and despite the modernization that earlier subsidies had paid for, Conrail would not become profitable even if it were given another $2 billion over the next five years. For the railroad to become self-sustaining and to return to private ownership, it added, it would have to be permitted to act "as any other business would when faced with large, money-losing operations."

Miraculously, Congress was momentarily convinced—whether because of the new Reagan administration's legislative momentum or simply because it saw big budgetary savings up the road. In 1981, as part of its omnibus budget reconciliation bill, it passed the Northeast Rail Service Act, and this time the remedy consisted not of bailouts but of deregulation. Specifically, the 1981 act ended the guarantees of

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lifetime employment for employees of the old Pennsylvania and New York Central, reduced the cost of paying off other discharged employees, gave Conrail the right to abandon unprofitable lines without ICC interference, and freed it from having to run commuter passenger trains. Under a new chairman (L. Stanley Crane, formerly with the Southern Railway) Conrail lost no time in aggressively exercising its new freedoms. By 1984, in one of the great but unacknowledged successes of deregulation, the lemon had turned into a peach: the railroad had moved from a $244 million loss four years earlier to a $500 million profit. (Credit also goes to the Staggers Act of 1980, which gave regulatory relief to the railroad industry in general.)

In addition to adopting the changes needed to make Conrail profitable, the new 1981 act empowered the secretary of transportation to sell the railroad—subject, however, to congressional approval. And the Reagan administration is now eager to do so, especially if it can recover some money to apply to the deficit. Secretary of Transportation Elizabeth Dole accordingly began soliciting purchase offers in the fall of 1983.

Even before a bidder was selected, Dole felt compelled to impose on the sale various conditions designed to protect the "public interest." In particular, she wrote, "we have an obligation to see that the new owner of Conrail stays in the railroad business"; the right buyer must have "a commitment to rail service in the Northeast." The worry here, of course, was that a buyer might "strip" or "dismantle" Conrail, presumably by selling those assets that are worth more elsewhere than employed in the Northeastern railroad business. Toward this goal of making sure that capital investment in the railroad stayed high (even if not compensated by economic return) Dole promised to include in any contract with the ultimate purchaser covenants that would set minimum levels of capital investment after the sale, limit permissible dividend payouts, and prohibit various service reductions and abandonments —in short, covenants that would reimpose many of the old 3R Act burdens that the 1981 act had eliminated.

More than a dozen bids came in by the June 1984 deadline, and the Department of Transportation narrowed down the field of bidders to the three that it considered most serious: Alleghany Corporation, a holding company with previous ties to the old Penn Central; a group of investors headed by J. Willard Marriott, Jr.; and Norfolk Southern, a large railroad that operates mostly in the midwest and southeast. All three bidders offered $1.2 billion. But Norfolk Southern was the only railroad among them, and there could hardly be a more sincere "commitment to rail service" than already operating a railroad. (There were some other factors working for Norfolk Southern, too; it was the only bidder that would finance its purchase without using any of Conrail's own cash.) In February, Dole announced that the department would back a Norfolk Southern purchase. The struggle immediately picked up stakes and moved to Congress.

Critics of the Norfolk Southern purchase fall into a number of categories. First are those shippers and trustbusters who worry that a Norfolk Southern acquisition would eliminate competition. The two railroads operate along a number of parallel lines, and some shippers that now benefit from competition might face a monopoly carrier.

The 1981 act seemingly provided only limited scope for antitrust review: the Department of Justice was supposed to have just ten days to render an advisory opinion after the secretary of transportation had proposed a purchaser. In fact, however, DOT brought the Antitrust Division in for consultations months before it announced its choice. But consultation was not the same as approval. Justice charged that the acquisition would violate both the Clayton Act and the Interstate Commerce Act unless both railroads were forced to sell some of their lines to competing carriers. The department went on to warn that it would oppose the sale unless the attorney general were given the power to pass on the adequacy of any proposed divestiture of assets.

The second group of critics consists of neighboring railroads that would like to grab bits of Conrail for their own. The Grand Trunk Western and the Pittsburgh & Lake Erie, for example, have come up with a plan dubbed "Prorail" that would allow them to acquire some of Conrail's lines against its will. DOT has also agreed to give some lines to Guilford Transportation Industries, which owns the Delaware & Hudson and the Boston and Maine.

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CSX, a large railroad that competes with Norfolk Southern, has also angled for some of Conrail's lines.

Forcing Conrail to donate lines parallel to its own might increase competition, of course, although some of the proposed divestments would simply transfer monopoly power from one railroad to another. On the other hand, divestments might disrupt the economies of scale and coordination that make rail mergers sensible in the first place.

Other complainants, however, object to the Norfolk merger not despite its possible cost savings but, in effect, because of them. Members of Congress from Pennsylvania and New Jersey are worried that Norfolk Southern will consolidate management and repair operations at its southern operating centers. They have demanded that Norfolk keep the Conrail headquarters in Philadelphia no matter what—invoking what might after the recent Phillips Petroleum case be called the Bartlesville principle, that corporate headquarters are, like freshwater supplies and pre-Columbian antiquities, a natural resource not to be alienated without government permission. Unions, likewise, fear possible cost-saving consolidations.

Finally, one group of critics would prefer a direct sale of the railroad's stock to the public. Conrail Chairman Crane, who favors this course, commissioned an analysis by investment bankers Morgan Stanley which predicted that the government could realize as much as $200 million more by selling the railroad through a public offering than it would get from any of the three bidders.

This option, whether carried out all at once or (more likely) in stages, would probably be the least intrusive option of all. It would remove the need for complex IRS tax rulings and would lessen the pressure for dismemberment and for abandonment restrictions. Of course, antitrust problems might arise if some competing railroad tried to accumulate Conrail stock, but those could be dealt with in the usual way, for better or worse. (The Morgan Stanley plan would limit single purchasers to less than 10 percent of Conrail stock, removing the possibility of a takeover.) Dole, however, has dismissed the public offering idea as too risky, declaring that "the federal government has a clear public interest obligation to know who will own a controlling interest in this railroad."

The sharp contrast between the failures of the 3R Act and the success of the 1981 act makes one thing clear: if the goal is to maximize the return on the taxpayers' investment while leaving Conrail in self-sustaining shape, the sale should bear a minimum of artificial burdens. The question is whether that goal is Congress's. If so, the lawmakers will have to say no to a powerful range of interests.

Goober Madness at the USDA

Back in 1930, U.S. farmers planted 1.1 million acres apiece of both peanuts and soybeans—two crops that have a lot in common in both biological and utilitarian terms. Then Congress decided to protect the small peanut farmer. (It left soybeans to the ravages of the marketplace.) Today, American farmers grow 1½ million acres of peanuts—and over 65 million acres of soybeans. The congressionally favored crop has been left in the dirt.

Congress has been helping to roast the peanut consumer since 1933, when it first instructed the Department of Agriculture to buy peanuts so as to prop up market prices. A decade or two later, the expense of this program had gotten out of hand, as more and more farmers had entered the business in search of guaranteed profits. So Congress passed another law essentially closing off the industry to newcomers in hopes of stemming the financial drain. The law prohibited anyone from growing peanuts without a federal license. The licenses went to incumbent farmers, and entitled them to continue growing peanuts on however many acres they had already planted in peanuts. This sort of entry prohibition applies to only a few other crops, most notably tobacco, but also (under federal marketing orders) hops, cranberries, spearmint oil, and Florida celery.

This system seemed perfectly suited to ensure unending prosperity in the peanut patch. The price supports kept peanut growing highly profitable, while the license system kept out potential competitors. Congress was happy to cultivate peanut farmers' votes at comparatively low budgetary expense, most of the subsidy being hidden at the grocery check-out counter.

Gradually, problems arose. Even if farmers did not compete with new entrants, they could

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compete with each other. They began producing one record crop after another on the permitted acreage, plowing in more fertilizer, new seed varieties, and new planting techniques. Peanut production per acre rose by 150 percent between 1957 and 1977. Since the support price was kept high, however, consumer demand did not grow apace, and the federal government had to buy up surplus peanuts. By 1976 Washington was spending $250 million for this purpose, and Agriculture Secretary Earl Butz complained that peanuts were "driving me crazy."

Finally, in 1977, Congress admitted that controlling acreage alone was not enough to do the trick. It took direct control over how many pounds each farmer grew, replacing acreage allotments with poundage allotments based on farmers' previous production. This set a ceiling on overall production: as farmers raised their productivity per acre, they would simply take some of their land out of peanut production.

There was still a great deal of budgetary pressure not to spend so much on buying surpluses. Thus Congress proceeded to cut the permitted poundage allotments 5 percent each year between 1978 and 1981, and another 20 percent in 1982. By this year, peanut poundage quotas will have dropped from 1.7 million tons in 1978 to 1.1 million tons. The poundage reductions have not been proportional: some farmers have managed to escape with smaller cuts than others. The formula was elaborate:

> The annual percentage reductions are to be shared equally among states. Farm reductions are to come first from farms owning quotas that do not have adequate tillable land to produce it; next, from farms where the quota has not been planted in 2 of the last 3 years; then, from farms where the quota has been leased away to another farm; and finally, from farms producing their own quota.

There were, of course, exceptions:

> Beginning with the 1979 crop, the farm quota was raised if the producer undermarketed his/her quota the previous year and if he/she had planted sufficient acreage, based on his/her farm yield in the previous year, to have expected to market his/her quota. The total of the undermarketing carryovers was restricted to 10 percent of the national quota, but an individual's carryover was *not limited unless the maximum was reached*. A producer did not risk losing or having the allotment reduced if he/she planted enough acreage, based on his/her farm yield, to produce at least 75% of his/her quota.

Local offices of the USDA's Agricultural Stabilization and Conservation Service had the final say on which farmers would lose their quotas. There was squawking from the peanut gallery, or at least parts of it, but to no avail.

The reduction in quotas may have been good news for taxpayers, but not of course for consumers, who go right on paying high prices. In fact, the cut in quotas has worsened the artificial scarcity of peanuts, driving domestic prices well above the already-high support prices. Prices rose from $440 a ton in 1977 to $675 a ton in 1983.

Until 1968, farmers could not sell their allotments even if they went out of business. After that, Congress allowed farmers to lease their quotas—so long as they had the personal permission from the secretary of agriculture. Even then the quotas could be leased only within the county of 1949 ordination. Later, farmers were allowed to sell their quotas outright, again on an intra-county basis. About half of all poundage quotas are now rented out, with a going rate of six cents a pound in Georgia.

The barriers to geographic mobility have led to glaring disparities in productivity between regions. Georgia peanut farmers produce an average of 3,279 pounds an acre, while Texans average only 1,415 pounds. More than 1 million acres are capable of producing 2,500–3,500 pounds an acre but are prohibited from producing for domestic consumption; at the same time, 25 percent of current quota acreage produces 1,700 pounds an acre or less.

As a recent USDA study noted, "If quota could be sold or leased across county or state lines, production would shift to the most profitable production regions. This could affect some local economies." Which is probably why it has never been allowed: although the allotment system was originally intended to protect small peanut farmers, it has been turned into a way to protect the local areas where peanuts have traditionally been grown. (It may also have encouraged bad farming practices. Texas peanut farmers do not rotate their crops as farmers usually do, and the unvaried peanut growing has depleted the soil of nutrients.)

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Until 1977 peanut farmers had little reason to export any of their production. USDA promised to buy all the peanuts quota holders could produce, and at a price that was almost always higher than the world market price; so farmers sold to the federal stockpile instead. USDA managed to get rid of some of its surplus through the Food for Peace program. The 1977 farm bill created a second tier of support prices, this time for exports, in order to encourage quota holders to grow peanuts for export in addition to quota peanuts. The support price for exports was much lower than that for domestic consumption—$250 a ton instead of $420—but still above the world price. Since 1981, anyone has been allowed to grow peanuts for export. These policies have stimulated peanut exports, which rose from 245,000 tons a year in the 1974–77 period to more than 400,000 tons a year recently, at a time when exports of wheat and corn, restrained by high price supports and the strong dollar, have fallen sharply.

USDA has had to concoct a lot of new regulations, however, to preserve its two-tier pricing system from erosion by normal market forces. Growers are required to sign contracts for shipment of their export peanuts before the crop is even planted, which spares the department the possible discomfort of having to take a crop off the hands of a farmer who finds no buyer. Export peanuts cannot be sent to Canada or Mexico in processed form, because USDA fears they could be reimported and take business away from the American product. (Imports have been conveniently limited by law to approximately 1 percent of domestic peanut consumption.)

When the Reagan administration came into office, it wanted at first to get rid of the peanut program. It soon changed its mind. In August 1981 President Reagan, who needed votes from three Georgia congressmen for the Gramm-Latta tax-cut bill, signed no less than a written pledge to preserve the program. Later that same year, he threw his support behind a bill raising the support price for domestic peanuts from $455 to $550 a ton, citing a huge jump in alleged production costs—based on figures for 1980, a year when a major drought had driven production costs sky-high. Since then, with production back to normal, peanut farmers have done quite well indeed compared with farmers generally.

Peanut processors appear eager to fight for reform of the program in this year's farm bill. An econometric study commissioned by their association recently asserted that the program raises consumer prices by about thirteen cents a pound, or more than $250 million a year. (Even the USDA, in a 1984 study, found that the program boosted domestic peanut prices by 13 percent.) The study further estimated that each one cent per pound increase in retail peanut prices cuts peanut consumption by 20 million pounds, which means the program cuts peanut consumption by 200 million pounds below what it would be under a free market. Low-income families are especially hurt because peanuts are (or would be) such an inexpensive source of nutrition.

The irony of the peanut program is that if controls were removed, peanut growing might support more, not fewer, farm families. Farmers are profitably growing peanuts for export at prices $150 a ton less than the government promises quota holders for growing for domestic consumption. The real effect of the current program, now as fifty years ago, is not to maximize the number of family farms—if that is itself any sort of coherent goal—but to transfer money from consumers to the owners of political capital. Possibly this year's farm bill will change that, but at last report the owners of peanut quotas did not seem to be very alarmed.

Airline Reservation Systems: Curse of the Mummy's Tomb

Just before the crypt of the Civil Aeronautics Board finally slammed shut, a gnarled hand reached up and grabbed the airline reservations network. On November 14 of last year, only six weeks before its demise, the board put into effect its final regulations governing airline-owned computer reservations systems (CRSs). And although the CAB gave up the ghost on regulating the airlines themselves, it has bequeathed to its institutional successor, the Department of Transportation, a tight grip on the airlines' main means of booking customers.

CRS systems are interactive computer data bases that travel agents use to check airline schedules and more important, make reserva-

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tions. By punching buttons on a terminal, an agent can call up information on flight schedules and fares, can book seats for clients, and can even reserve hotel rooms and rental cars.

The CRS networks grew out of internal systems that individual airlines had adopted to control their own logistical operations. Some of the larger carriers, spying a chance to gain publicity as well as revenue, began revamping these systems and marketing them to travel agents. Agents, however, wanted the CRS providers to list other airlines' flights as well as their own, since it was expensive to maintain separate terminals for each airline. Thus most systems came to include most carriers. (There were a number of cooperative efforts to set up a common industry system, but all failed, in part because the government hinted that they might violate antitrust laws.)

Listing other airlines' flights on a CRS system benefits both the host airline, which gains comprehensiveness for its system, and the other airlines, which gain publicity and easier ticket writing. The classic economic relationship of this sort is that between beekeepers and orchard owners: sometimes beekeepers charge a fee for pollination services, sometimes they themselves must pay to obtain forage for their bees, depending on supply and demand. In this case, CRS providers generally charged a fee for listing competing carriers, but gave larger competitors a discount because their flight information was more in demand and thus more critical in marketing CRS systems to travel agents. In effect, CRS systems are like newspapers that get revenues from both "readers" (travel agents) and "advertisers" (carriers)—though, of course, CRS systems are owned by their major "advertisers."

Two CRS systems, United's APOLLO and American's SABRE, have come to occupy the major share of the industry. The two seem to compete vigorously with each other, although when one carrier dominates air traffic in a city, like United in Denver or American in Dallas, its reservation system tends to be dominant too.

The "search routine" of the CRS software program determines the order in which flights appear on the screen. APOLLO, for example, lists nonstop and direct flights first, on-line connecting flights second, and off-line connecting flights last. Within each category, a search routine must make many more "decisions" as to which flights to list first. Not all flights between two points wind up being listed on a single screen; the display screen on APOLLO can handle a maximum of eight flights. Overflow data appear on additional screens that the user can easily call up.

Not surprisingly, CRS providers structured the decision process in ways that tended to list their own flights before their competitors'—a phenomenon that rival airlines tagged as "bias." Sometimes the "bias" was relatively explicit, as when the names of carriers were used as search criteria. ("Look ahead one hour for Carrier A's flights, but only half an hour for Carrier B's.") But as in the civil rights area, there are innumerable forms of "statistical bias" as well. Connecting flights, for instance, might be listed in an order that depends on the city they connect through, and the system might look at the host airline's own "hub" before its competitors'. Seat capacity might be a good search criterion for a host airline with a wide-body fleet. Rival airlines and some travel agents demanded that the CAB prohibit bias and regulate the CRS industry in other ways as well.

The word "bias" is loaded, of course, but in this context it may be empty as well. CRS display screens deliberately show customers some products before others, but then so do department-store clerks; spotlighting the items that are the biggest profit generators is standard practice in the retail business. Likewise, cigarette, candy, and magazine companies commonly provide drug stores with display racks that hold a number of different brands, but give the most prominence to their own. No false pretenses are involved, and consumers are well aware that it pays to probe. (Travel agents are among the more sophisticated consumers or, in this case, representatives of consumers.)

An even closer analogy is that of supermarkets, which commonly stock "national" brands that compete head-on with their "house" brands. In effect, the national manufacturer is bidding for shelf space against the store's own products. And frequently it wins this competition: the store gives "preferred" shelf space to the national brand or sometimes even discontinues the house brand. The national manufacturer will win such a competition if its product offers the store a higher return per unit of shelf space than the house brand. It may, for exam-

(Continues on page 55)

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For about a half century, courts have followed the general doctrine that the Constitution imposes few restraints on legislative efforts to regulate economic matters. In recent years, this doctrine has been hotly debated within conservative circles. These essays, based on remarks given in October at the Cato Institute's Conference on Economic Liberties and the Judiciary, are part of that debate.

On the Merits of the Frying Pan

Antonin Scalia

I RECALL FROM THE earliest days of my political awareness Dwight Eisenhower's demonstrably successful slogan that he was "a conservative in economic affairs, but a liberal in human affairs." I am sure he meant it to connote nothing more profound than that he represented the best of both Republican and Democratic tradition. But still, that seemed to me a peculiar way to put it—contrasting economic affairs with human affairs as though economics is a science developed for the benefit of dogs or trees; something that has nothing to do with human beings, with their welfare, aspirations, or freedoms.

That, of course, is a pernicious notion, though it represents a turn of mind that characterizes much American political thought. It leads to the conclusion that economic rights and liberties are qualitatively distinct from, and fundamentally inferior to, other noble human values called civil rights, about which we should be more generous. Unless one is a thoroughgoing materialist, there is some appeal to this. Surely the freedom to dispose of one's property as one pleases, for example, is not as high an aspiration as the freedom to think or write or worship as one's conscience dictates. On closer analysis, however, it seems to me that the difference between economic freedoms and what are generally called civil rights turns out to be a difference of degree rather than of kind. Few of us, I suspect, would have much difficulty choosing between the right to own property and the right to receive a Miranda warning.

In any case, in the real world a stark dichotomy between economic freedoms and civil rights does not exist. Human liberties of various types are dependent on one another, and it may well be that the most humble of them is indispensable to the others—the firmament, so to speak, upon which the high spires of the most exalted freedoms ultimately rest. I know no society, today or in any era of history, in which high degrees of intellectual and political freedom have flourished side by side with a high degree of state control over the relevant citizen's economic life. The free market, which presupposes relatively broad economic freedom, has historically been the cradle of broad political freedom, and in modern times the demise of economic freedom has been the grave of political freedom as well. The same phenomenon is observable in the small scales of our private lives. As a practical matter, he who controls my economic destiny controls much more

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of my life as well. Most salaried professionals do not consider themselves "free" to go about wearing sandals and nehru jackets, or to write letters on any subjects they please to the *New York Times*.

MY CONCERN IN THIS ESSAY, however, is not economic liberty in general, but economic liberty and the judiciary. One must approach this topic with the realization that the courts are (in most contexts, at least) hardly disparaging of economic rights and liberties. Although most of the cases you read of in the newspaper may involve busing, or homosexual rights, or the supervision of school districts and mental institutions, the vast bulk of the courts' civil business consists of the vindication of economic rights between private individuals and against the government. Indeed, even the vast bulk of noncriminal "civil rights" cases are really cases involving economic disputes. The legal basis for the plaintiff's claim may be sex discrimination, but what she is really complaining about is that someone did her out of a job. Even the particular court on which I sit, which because of its location probably gets an inordinately large share of civil cases *not* involving economic rights, still finds that the majority of its business consists of enforcing economic rights against the government—the right to conduct business in an unregulated fashion where Congress has authorized no regulation, or the right to receive a fair return upon capital invested in a rate-regulated business. Indeed, some of the economic interests protected by my court are quite rarefied, such as a business's right to remain free of economic competition from a government licensee whose license is defective in a respect having nothing to do with the plaintiff's interests—for example, one radio station's challenge to the license of a competing station on the basis that the competitor will produce electronic interference with a third station.

Fundamental or rarefied, the point is that we, the judiciary, do a lot of protecting of economic rights and liberties. The problem that some see is that this protection in the federal courts runs only by and large against the executive branch and not against the Congress. We will ensure that the executive does not impose any constraints upon economic activity which Congress has not authorized; and that where constraints *are* authorized the executive follows statutorily prescribed procedures and that the executive (and, much more rarely, Congress in its prescriptions) follows constitutionally required procedures. But we will never (well, hardly ever) decree that the substance of the congressionally authorized constraint is unlawful. That is to say, we do not provide a *constitutionalized* protection except insofar as matters of process, as opposed to substantive economic rights, are concerned.

There are those who urge reversal of this practice. The main vehicle available—and the only one I address specifically here—is the due process clause of the Fifth and Fourteenth Amendments, which provides that no person shall be deprived of "life, liberty, or property, without due process of law." Although one might suppose that a reference to "process" places limitations only upon the *manner* in which a thing may be done, and not upon the *doing* of it, since at least the late 1800s the federal courts have in fact interpreted these clauses to prohibit the *substance* of certain governmental action, no matter what fair and legitimate procedures attend that substance. Thus, there has come to develop a judicial vocabulary which refers (seemingly redundantly) to "procedural due process" on the one hand, and (seemingly paradoxically) to "substantive due process" on the other hand. Until the mid-1930s, substantive due process rights were extended not merely to what we would now term "civil rights"—for example, the freedom to teach one's child a foreign language if one wishes—but also to a broad range of economic rights—for example, the right to work twelve hours a day if one wishes. Since that time, application of the concept has been consistently expanded in the civil rights field (*Roe* v. *Wade* is the most controversial recent extension) but entirely eliminated in the field of economic rights. Some urge that it should be resuscitated.

I pause to note at this point, lest I either be credited with what is good in the present system or blamed for what is bad, that it is not up to me. (I did not have to make that disclaimer a few years ago, when I was a law professor.) The Supreme Court decisions rejecting substantive due process in the economic field are clear, unequivocal and current, and as an appellate judge I try to do what I'm told. But I will go beyond that disclaimer and say that in

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my view the position the Supreme Court has arrived at is good—or at least that the suggestion that it change its position is even worse.

AS SHOULD BE APPARENT from what I said above, my position is not based on the proposition that economic rights are unimportant. Nor do I necessarily quarrel with the specific nature of the particular economic rights that the most sagacious of the proponents of substantive due process would bring within the protection of the Constitution; were I a legislator, I might well vote for them. Rather, my skepticism arises from misgivings about, first, the effect of such expansion on the behavior of courts in other areas quite separate from economic liberty, and second, the ability of the courts to limit their constitutionalizing to those elements of economic liberty that are sensible. I will say a few words about each.

First, the effect of constitutionalizing substantive economic guarantees on the behavior of the courts in other areas: There is an inevitable connection between judges' ability and willingness to craft substantive due process guarantees in the economic field and their ability and willingness to do it elsewhere. Many believe—and among those many are some of the same people who urge an expansion of economic due process rights—that our system already suffers from relatively recent constitutionalizing, and thus judicializing, of social judgments that ought better be left to the democratic process. The courts, they feel, have come to be regarded as an alternate legislature, whose charge differs from that of the ordinary legislature in the respect that while the latter may enact into law good ideas, the former may enact into law only *unquestionably* good ideas, which, since they *are* so unquestionably good, *must* be part of the Constitution. I would not adopt such an extravagant description of the problem. But I do believe that every era raises its own peculiar threat to constitutional democracy, and that the attitude of mind thus caricatured represents the distinctive threat of our times. And I therefore believe that whatever reinforces rather than challenges that attitude is to that extent undesirable. It seems to me that the reversal of a half-century of judicial restraint in the economic realm comes within that category. In the long run, and perhaps even in the short run, the reinforcement of mistaken and unconstitutional perceptions of the role of the courts in our system far outweighs whatever evils may have accrued from undue judicial abstention in the economic field.

The response to my concern, I suppose, is that the connection I assert between judicial intervention in the economic realm and in other realms can simply not be shown to exist. We have substantive due process aplenty in the field of civil liberties, even while it has been obliterated in the economic field. My rejoinder is simply an abiding faith that logic will out. Litigants before me often characterize the argument that if the court does *w* (which is desirable) then it must logically do *x*, *y*, and *z* (which are undesirable) as a "parade of horribles"; but in my years at the law I have too often seen the end of the parade come by. There really is an inevitable tug of logical consistency upon human affairs, and especially upon judicial affairs—indeed, that is the only thing that makes the system work. So I must believe that as bad as some feel judicial "activism" has gotten without substantive due process in the economic field, *without* that memento of judicial humility it might have gotten even worse. And I have little hope that judicial and lawyerly attitudes can be coaxed back to a more restricted view of the courts' role in a democratic society at the same time that we are charging forward on an entirely new front.

[Conservatives] must decide whether they really believe . . . that the courts are doing too much, or whether they are actually nursing only the less principled grievance that the courts have not been doing what they want.

Though it is something of an oversimplification, I do not think it unfair to say that this issue presents the moment of truth for many conservatives who have been criticizing the courts in recent years. They must decide whether they really believe, as they have been saying, that the courts are doing too much, or whether they are actually nursing only the less principled grievance that the courts have not been doing what *they* want.

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The second basis for my skepticism is the absence of any reason to believe that the courts would limit their constitutionalizing of economic rights to those rights that are sensible. In this regard some conservatives seem to make the same mistake they so persuasively argue the society makes whenever it unthinkingly calls in government regulation to remedy a "market failure." It is first necessary to make sure, they have persuaded us, that the cure is not worse than the disease—that the phenomenon of "government failure," attributable to the fact that the government, like the market, happens to be composed of self-interested human beings, will not leave the last state of the problem worse than the first. It strikes me as peculiar that these same rational free-market proponents will unthinkingly call in the courts as a *deus ex machina* to solve what they perceive as the problems of democratic inadequacy in the field of economic rights. Is there much reason to believe that the courts, if they undertook the task, would do a good job? If economic sophistication is the touchstone, it suffices to observe that these are the folks who developed three-quarters of a century of counterproductive law under the Sherman Act. But perhaps what counts is not economic sophistication, but rather a favoritism—not shared by the political branches of government—toward the institution of property and its protection. I have no doubt that judges once met this qualification. When Madison described them as a "natural aristocracy," I am sure he had in mind an aristocracy of property as well as of manners. But with the proliferation and consequent bureaucratization of the courts, the relative modesty of judicial salaries, and above all the development of lawyers (and hence of judges) through a system of generally available university education which, in this country as in others, more often nurtures collectivist than capitalist philosophy, one would be foolish to look for Daddy Warbucks on the bench.

But, the proponents of constitutionalized economic rights will object, we do not propose an open-ended, unlimited charter to the courts to create economic rights, but would tie the content of those rights to the text of the Constitution and, where the text is itself somewhat open-ended (the due process clause, for example), to established (if recently forgotten) constitutional traditions. As a theoretical matter, that could be done—though it is infinitely more difficult today than it was fifty years ago. Because of the courts' long retirement from the field of constitutional economics, and because of judicial and legislative developments in other fields, the social consensus as to what are the limited, "core" economic rights does not exist today as it perhaps once did. But even if it is theoretically possible for the courts to mark out limits to their intervention, it is hard to be confident that they would do so. We may find ourselves burdened with judicially prescribed economic liberties that are worse than the preexisting economic bondage. What would you think, for example, of a substantive-due-process, constitutionally guaranteed, economic right of every worker to "just and favorable remuneration ensuring for himself and his family an existence worthy of human dignity?" Many think this a precept of natural law; why not of the Constitution? A sort of constitutionally prescribed (and thus judicially determined) minimum wage. Lest it be thought fanciful, I have taken the formulation of this right verbatim from Article 23 of the United Nations' Universal Declaration of Human Rights.

We may find ourselves burdened with judicially prescribed economic liberties that are worse than the preexisting economic bondage.

FINALLY, LET ME SUGGEST that the call for creating (or, if you prefer, "reestablishing") economic constitutional guarantees mistakes the nature and effect of the constitutionalizing process. To some degree, a constitutional guarantee is like a commercial loan: you can only get it if, at the time, you don't really need it. The most important, enduring, and stable portions of the Constitution represent such a deep social consensus that one suspects that if they were entirely eliminated, very little would change. And the converse is also true. A guarantee may appear in the words of the Constitution, but when the society ceases to possess an abiding belief in it, it has no living effect. Consider the fate of the principle expressed in the

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Tenth Amendment that the federal government is a government of limited powers. I do not suggest that constitutionalization has no effect in helping the society to preserve allegiance to its fundamental principles. That is the whole purpose of a constitution. But the allegiance comes first and the preservation afterwards.

Most of the constitutionalizing of civil rights that the courts have effected in recent years has been at the margins of well-established and deeply held social beliefs. Even *Brown* v. *Board of Education,* as significant a step as it might have seemed, was only an elaboration of the consequences of the nation's deep belief in the equality of all persons before the law. Where the Court has tried to go further than that (the unsuccessful attempt to eliminate the death penalty, to take one of the currently less controversial examples), the results have been precarious. Unless I have been on the bench so long that I no longer have any feel for popular sentiment, I do not detect the sort of national commitment to most of the economic liberties generally discussed that would enable even an activist court to constitutionalize them. That lack of sentiment may be regrettable, but to seek to develop it by enshrining the unaccepted principles in the Constitution is to place the cart before the horse.

If you are interested in economic liberties, then, the first step is to recall the society to that belief in their importance which (I have no doubt) the founders of the republic shared. That may be no simple task, because the roots of the problem extend as deeply into modern theology as into modern social thought. I remember a conversation with Irving Kristol some years ago, in which he expressed gratitude that his half of the Judeo-Christian heritage had never thought it a sin to be rich. In fact my half never thought it so either. Voluntary poverty, like voluntary celibacy, was a counsel of perfection—but it was not thought that either wealth or marriage was inherently evil, or a condition that the just society should seek to stamp out. But that subtle distinction has assuredly been forgotten, and we live in an age in which many Christians are predisposed to believe that John D. Rockefeller, for all his piety (he founded the University of Chicago as a Baptist institution), is likely to be damned and Ché Guevara, for all his nonbelief, is likely to be among the elect. This suggests that the task of creating what I might call a constitutional *ethos* of economic liberty is no easy one. But it is the first task. ■

Economic Liberties and the Judiciary

The Active Virtues

Richard A. Epstein

ANTONIN SCALIA HAS EXPLAINED why he believes courts should refrain from intervening to protect what are generally described as economic liberties—chiefly, the right to own and use property and the right to dispose of both property and labor by contract. In so doing, he has recounted at length all the errors and confusions that beset courts when they try to vindicate these basic economic rights by constitutional means.

There are powerful reasons that explain why judges may do badly in this endeavor. They are isolated, and they tend to be drawn from political or social elites. Their competence on economic matters is often limited. When they pass on complex legislation, they often misunderstand its purpose and effect. By any standard, the error rate of their decisions has been

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high. I cannot challenge his conclusions simply by saying that he underestimates the sterling performance of his colleagues on the bench. If the only issue were judicial competence, Scalia's conclusion would swiftly follow: since courts cannot master economic matters, they should adopt a form of judicial laissez faire that keeps judges' hands off the economic system.

As stated, Scalia's plea for judicial restraint is not a defense of legal anarchy. Instead, it accepts government control over economic affairs, but guarantees that this control will be exercised by the legislative and executive branches of government (as well as the administrative agencies they have created). By necessity, only political checks are available to ensure that national policy does not stray too far from the social consensus.

Scalia's position represents the mainstream of American constitutional theory today. My purpose is to take issue with the conventional wisdom. I hope to persuade Scalia to take upon himself, and to pursue energetically, the tasks that our Constitution assigns to him and to other federal judges. Note that in urging this course I speak as an academic who would impose on sitting judges duties more extensive than they themselves are often willing to assume.

IN MY VIEW, Scalia has addressed only one side of a two-sided problem. He has pointed out the weaknesses of judicial action. But he has not paid sufficient attention to the errors and dangers in unchanneled legislative behavior. The only way to reach a balanced, informed judgment on the intrinsic desirability of judicial control of economic liberties is to consider the *relative* shortcomings of the two institutions—judicial and legislative—that compete for the crown of final authority. The constitutionality of legislation restricting economic liberties cannot be decided solely by appealing to an initial presumption in favor of judicial restraint. Instead the imperfections of the judicial system must be matched with the imperfections of the political branches of government.

What are the problems with legislation? When we put someone in charge of the collective purse or the police force, we in effect give him a spigot that allows him to tap into other people's property, money, and liberty. The legislator that casts a vote on an appropriations bill is spending not only his own wealth, but everyone else's. When the power of coalition, the power of factions, the power of artifice and strategy come into play, it often turns out that legislatures reach results that (in the long as well as the short run) are far from the social optimum.

To take the limiting case, suppose a group of people have a profound and anxious debate, and then decide, by a bare majority, that the prevailing distribution of wealth is wrong. So the 51 percent decide to condemn, without payment, all the property of the 49 percent. Strict majoritarian principles would allow them to get away with that. But Scalia and others would say, "It cannot be done because the eminent domain clause in our Constitution provides that when government takes private property for public use, it must pay." The winners in a legislative battle may not confiscate the property of the losers.

Now, note the slippery slope. We have identified a form of legislative failure, along with a constitutional provision that seems to respond to that kind of failure. The first step down the slope is the announcement that a particular piece of legislation, even if it reflects the consensus of the population at large, is not going to work. And once we take that step, where in principle do we stop? Suppose we change the dynamics of coalition building, so that it takes 80 percent of the population to confiscate the wealth of the other 20 percent. Does this broader consensus mean that the program is acceptable and can proceed? Or are the perils of faction not indeed, in many ways, even greater in the second case than they were before, since the minority is now more isolated and less able to defend itself in the legislative forum?

Once one starts down the slippery slope, one cannot stop, at least without a theory. Intellectually, we must conclude that much of the impetus behind legislative behavior is to induce forced exchanges—to take from some people more than they get in exchange, in order to provide benefits to those who happen to control the political levers. To some extent this is unavoidable, since we need a system of collective controls in order to operate the police, the courts, the national defense, and so on. And

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the opportunities for abuse in the operations of government are inseparable from that collective need.

THE THEORY OF CONSTITUTIONALISM, as I understand it, tries to find a way to minimize the sum of the abuses that stem from legislative greed on the one hand, and judicial incompetence on the other. There is, by and large, no third alternative to this sorry state of affairs. What I fear is wrong with Scalia's statement of the argument is this: by focusing exclusively on the defects he finds in the judicial part of the process, he tends to ignore the powerful defects that pervade the legislative part of the process. Our constitution reflects a general distrust toward the political process of government—a high degree of risk aversion. That is why it wisely spreads the powers of government among different institutions through a system of checks and balances. To provide no (or at least no effective) check on the legislature's power to regulate economic liberties is to concentrate power in ways that are inconsistent with the need to diversify risk. To allow courts to strike down legislation, but never to pass it, helps to control political abuse without undermining the distinctive features of the separate branches of government. Once we realize that all human institutions (being peopled by people) are prey to error, the only thing we can hope to do is to minimize those errors so that the productive activities of society can go forward as little hampered as possible.

. . . by focusing exclusively on the defects he finds in the judicial part of the process, [Scalia] tends to ignore the powerful defects that pervade the legislative part of the process.

Thus far I have been discussing general political theory: how is it that one would want to organize a constitution? But we do not have to talk about constitutions in the round and in the abstract. We have an actual constitution, and since it is a written one, we can check to see how it handles the particular problem of protecting economic liberties.

To listen to my colleague—and to the many other advocates of judicial restraint—one would almost think that the Constitution contained only the following kinds of provisions: those organizing a judiciary, a legislature, and an executive; and those providing for separation of powers, checks and balances, and so on. All those devices—efforts to divide and conquer the governing power—are efforts to limit the abuses of factions. But they are not the only provisions our Constitution contains. It also contains many broad and powerful clauses designed to limit the jurisdiction of both federal and state governments. The commerce clause, at least in its original conception, comes to mind. Other clauses are designed to limit what the states and the federal government can do within the scope of their admitted powers. These include the eminent domain clause (which always bound the federal government and since the Civil War Amendments has bound the states as well), the contracts clause, the privileges and immunities clause of both the original Constitution and the Bill of Rights, the equal protection clause, and due process.

These provisions are not curlicues on the margins of the document; they are not without force or consequence. They are provisions designed to preserve definite boundaries between public and private ordering. Take the question of minimum wages. The principle of freedom of contract—that parties should be free to set wage terms as they see fit—is, given the contracts clause, on a collision course with that sort of legislative regulation of the economy. So it is with the eminent domain question discussed above. Many of the particular provisions of the Constitution are designed to deal with the very kinds of questions that political theory indicates to be sources of our enormous uneasiness and distrust of the legislative process.

THE NEXT QUESTION IS how have these constitutional provisions been interpreted in actual practice? A key element is the "rational basis" test, which holds that so long as there is some "plausible" or "conceivable" justification for the challenged legislation, it is invulnerable to constitutional attack. Under the guise of this test, judges have decided that the last thing they will do is look hard and analytically at any political institution, at any legislative action,

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that regulates economic affairs. It turns out that Scalia's position, already stated even more forcefully by the Supreme Court itself, completely abandons the idea that serious intellectual discussion can yield right and wrong answers on matters of political organization and constitutional interpretation. Courts simply give up before they try, and embrace an appalling sort of ethical noncognitivism. Anything legislatures do is as good as anything else they might have done; we cannot decide what is right or wrong, so it is up to Congress and the states to determine the limitations of their own power—which, of course, totally subverts the original constitutional arrangement of limited government.

Part of the explanation for the judiciary's poor performance now becomes clear. When courts do not try, they cannot succeed. When they use transparent arguments to justify dubious legislation, they cannot raise the level of debate. When courts (following the lead of the Supreme Court) hold that the state has the right to say X, when they know X is wrong, they fritter away their own political authority on an indefensible cause.

But can matters ever be this clear? In some instances it has seemed that no conceivable interpretation of the constitutional text could generate or justify the results that the Supreme Court has been prepared to reach. Take its decision in *Hawaiian Housing Authority* v. *Midkiff* (1984). There is a good reason why the constitutional clause restricting the seizure of property by eminent domain contains a provision specifying that the seizure must be for public use. The last thing one needs a government for is to arrange a set of coerced transfers between A and B when voluntary markets can arrange the same transfers without the abuses of faction. For the most part, this means that when we want the government to take property, we want it to do so in order to generate a public good, some nonexclusive benefit, that a private market cannot generate. Legislation (like that challenged in *Midkiff*) which simply takes land and transfers it from landlords to tenants, or the reverse, constitutes the paradigmatic transaction that the eminent domain clause was designed to prohibit. So when the Court sustained the Hawaiian statute, it declared the central wrong to be perfectly legal. The Justices stood the Constitution on its head. They said, in effect, that although the eminent domain clause must have been put there for some purpose, we cannot figure out what that purpose might be, so we might as well read it out of the document and act as if it had never existed.

The courts have shown the same pattern of behavior in other cases. For example, it seems clear today that they will no longer construe the police power to protect private contracts of any sort—even when those contracts complied with all applicable rules at the time of their formation. What does a clause that prohibits impairing the obligation of contracts mean? Today, it turns out (with only minor exaggeration) that a legislature can simply decide to nullify contractual provisions on the grounds that this legally imposed breach of contract makes one of the contracting parties better off than it was before. If that is the only test, then every contract is vulnerable to judicial nullification.

This judicial deference in the protection of economic rights has enormous costs. The moment courts allow all private rights to become unstable and subject to collective (legislative) determination, all of the general productive activities of society will have to take on a new form. People will no longer be able to plan private arrangements secure in the knowledge of their social protection. Instead, they will take the same attitude toward domestic investment that they take toward foreign investment. Assuming that their enterprise will be confiscated within a certain number of years, domestic investors will make only those investments with a high rate of return and short payout period, so that when they see confiscation coming, they will be able to run. To be sure, the probability of expropriation is greater in many foreign contracts than it is in the United States. But given our record of price controls and selective industry regulation, it is clear that the once great protections we enjoyed have been compromised, and for no desirable social goal.

I SUBMIT THAT THIS is not what we want legislatures to do. It is wrongheaded to argue that, because an auditor cannot hope to correct every abuse in the Defense Department's procurement policies, he should therefore refuse to go after the $5,000 coffee pot—or that because a judge cannot hope to correct every infringe-

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ment of economic liberties, he should therefore refuse to go after large-lot zoning restrictions. There are many blatantly inappropriate statutes that cry out for a quick and easy kill. Striking them down puts no particular strain on the judiciary. To invalidate a statute, a judge need not make complex factual determinations or continually supervise large branches of the federal government. He need not take over school boards, try to run prisons or mental hospitals, or demand that Congress appropriate funds. He need only say that, in certain circumstances, the government cannot do something —period—while in other circumstances, it can, but must pay those people on whom it imposes a disproportionate burden.

Government exists, after all, because the market's ability to organize forced exchanges is limited. We need to collect taxes, to impose regulations, to assign rights and liabilities through a centralized process, but only for limited public purposes. Our guiding principle should derive from our Lockean tradition—a tradition that speaks about justice and natural rights, a tradition that understands the importance of the autonomy of the person, and respects it in religion, in speech, and in ordinary day-to-day affairs. When government wishes to encroach on those rights in order to discharge its collective functions, it must give all the individuals on whom it imposes its obligations a fair equivalent in exchange. It may be that it is not always possible to measure that equivalence. Possibly we cannot achieve the goal of full compensation and simultaneously provide the collective goods. I am prepared to debate at great length where the proper margins are with respect to the application of this general principle. What I am not prepared to say is that we can organize our society on the belief that the question I just posed is not worth asking. Consequently, when the government announces that it has provided a comparable benefit, courts should not take its word on faith, when everything in the record points indubitably to the opposite conclusion.

WHEN ONE COMPARES the original Constitution with the present state of judicial interpretation, the real issue becomes not how to protect the status quo, but what kinds of incremental adjustments should be made in order to shift the balance back toward the original design. On this question, we can say two things. First, at the very least, we do not want to remove what feeble protection still remains for economic liberties. Any further judicial abdication in this area will only invite further legislative intrigue and more irresponsible legislation. Yet recent Supreme Court decisions have tended to invite just that. Second, since courts are bound to some extent by a larger social reality, we cannot pretend that the New Deal never happened. Rather, we must strive to regain sight of the proper objectives of constitutional government and the proper distribution of powers between the legislatures and the courts, so as to come up with the kinds of incremental adjustments that might help us to restore the proper constitutional balance.

Judicial restraint is fine when it keeps courts from intervening in areas where they have no business intervening. But the world always has two kinds of errors: the error of commission (type I) and the error of omission (type II). In the context of our discussion, type I error refers to the probability of judicial intervention to protect economic rights when such intervention is not justified by constitutional provisions. And type II error refers to the probability of foregoing judicial intervention to protect economic liberties when such intervention is justified. This second type of error cannot be ignored.

What Scalia has, in effect, argued for is to minimize type I error. We run our system by being most afraid of intervention where it is not appropriate. My view is that we should minimize both types of error. One only has to read the opinions of the Supreme Court on economic liberties and property rights to realize that these opinions are intellectually incoherent and that some movement in the direction of judicial activism is clearly indicated. The only sensible disagreement is over the nature, the intensity, and the duration of the shift.

At this point, the division of power within the legal system is not in an advantageous equilibrium. If the judiciary continues on its path of self-restraint with respect to economic liberties, we will continue to suffer social and institutional losses that could have been reduced by the prudent judicial control that would result from taking the constitutional protections of economic liberties at their face value. ■

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Foul Play in "Public Interest" Litigation

The Joy of Attorneys' Fees

Grover Rees III

AMERICANS ENJOY A uniquely generous and broadminded political culture. One evidence of this is that we reward with a prominent place in our national life organizations whose principal purpose is to sue us. We even pay them to sue us. Under a number of federal laws, most notably the Civil Rights Attorney's Fee Awards Act of 1976, a lawyer who wins a civil or constitutional rights case will be paid not by his client but by the losing party—which, in a successful civil rights suit, is typically some branch of the government.

The lawyer who pursues a career in civil rights litigation is in effect a uniquely unaccountable employee of the taxpayers, paid not to advance his benefactors' objectives but to defeat them. Moreover, the attorney is frequently paid enough for each case he wins to subsidize several unsuccessful lawsuits in which the government is held not to have violated anybody's rights. Whatever its costs in money and in wear and tear on the theory of democracy, this system would seem to have at least one advantage. It should virtually eliminate the chance that anybody who has an arguable civil right to anything will be financially unable to show up in court to assert that right. That is why a recent development in the world of civil rights attorneys' fees is of great interest. For what is apparently the first time, a judge has awarded attorneys' fees against people who had intervened in a case not because they were accused of violating anybody's rights but because they wished to protect their own. (The case is *Akron Center for Reproductive Health, Inc.* v. *City of Akron*, 1984.)

In 1978 the city of Akron, Ohio, passed an ordinance requiring the consent of at least one parent before an abortion could be performed on a girl of fourteen years old or younger. The ordinance further provided that parents should ordinarily be notified before an abortion was performed on a girl of seventeen or younger. A lawyer for the American Civil Liberties Union (ACLU), representing a doctor and three abortion clinics, sued to have the ordinance declared unconstitutional. The federal district court agreed with the ACLU, and the Supreme Court upheld the decision. So far, nothing unusual.

There was a further twist, however. Patricia Black and Dr. Francois Seguin, two Akron residents who are parents of teenage daughters, had intervened in the suit on the side of the defendant, Akron. They had argued

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that the notice and consent provisions protected their right to raise their children without undue interference from the clinics. And for having raised that argument, Mrs. Black and Dr. Seguin will have to pay dearly. The ACLU asked and got the district court to make them pick up an as yet undetermined portion of its legal services, the value of which it estimates at $463,000.

The only attention the Akron case has received in the press or even in the legal profession has been as a chapter in the ongoing struggle between the "pro-life" and "pro-choice" movements. The holding that attorneys' fees should be awarded against individual intervenors, however, has implications far beyond the context of abortion. If followed in other cases, this holding could make it prohibitively risky for the beneficiaries of *any* law or administrative regulation to defend in court the rights to which the law or regulation entitles them. This, in turn, will affect the path of the law itself.

The Joy of Attorneys' Fees

In the American legal system, courts generally do not award attorneys' fees to victorious litigants. This rule and its narrow exceptions reflect a recognition of two principles of human behavior: What you subsidize you get more of, and what you penalize you get less of. Thus attorneys' fees have traditionally been awarded against litigants whose claims or defenses are judged to have been frivolous, since we want to discourage people from cluttering up the courts with frivolity. On the other hand, fees are not generally awarded against litigants whose arguments were unsuccessful but not altogether unreasonable.

This means in practice that winners will not be fully compensated, since they will have been forced to pay lawyers in order to obtain what the law has found to be rightfully theirs. The prospect of these uncompensated expenses will even deter some people from asserting claims or defenses that would ultimately have prevailed. But the alternative, which is to saddle the loser with two sets of attorneys' fees, has an even stronger chilling effect. The potential litigant finds it unpleasant enough to retain a lawyer and to agree on a fee, but far worse to face the prospect of having to pay an uncontrollable, open-ended second fee that depends on what the opposing lawyers might eventually persuade the court their work was worth. Indeed, by eliminating the most significant incentive a lawyer has to hold down his fees and expenses—the need to find clients who will pay what he would like to charge—this alternative not only would redistribute but also increase the total cost of litigation. A system in which losers always had to pay attorneys' fees might deter all but the wealthiest and least risk-averse people from asserting what they believe in good faith to be—and what the courts might well hold to be—their legal rights.

Several justifications have been advanced for allowing attorneys' fees in civil and constitutional rights cases. Mostly it is argued that without such a provision individual plaintiffs would far more often be deterred from bringing meritorious claims than governments would be deterred from defending themselves. Governments tend not only to be wealthier than individuals but also to employ staff attorneys at fixed salaries, so that the marginal cost of defending one more suit will ordinarily be lower than the cost to an individual plaintiff of bringing the suit. Moreover, the government official who decides whether to defend or settle a lawsuit will not be paying the costs from his own pocket, so that even the threat of having to pay the attorneys' fees of the opposition will probably have less of a chilling effect on governments than on individuals. Insofar as large fee awards do make them think twice about defending doubtful cases, governments may start to behave more like people.

. . . the federal courts have awarded fees high enough to provide a strong incentive for lawyers themselves to generate litigation.

The 1976 attorneys' fee law and similar statutes, however, have done more than just rectify an imbalance on the supply side of the litigation market. They have also stimulated demand, primarily because the federal courts have awarded fees high enough to provide a strong incentive for lawyers themselves to generate litigation.

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Correction
In "Readings," September/December 1984, the title of J. R. S. Prichard's anthology was misstated. The correct title is as listed above.

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The Economics of Fuel Economy Standards

David R. Henderson

WHY DID GENERAL MOTORS announce in April 1984 that because *large* car sales were unusually strong, it would extend *small* car production until October or November? Why did GM consider producing its large station wagon as a light truck instead of as a car? And what do many auto industry analysts ignore when they predict that the Big Three (GM, Ford, and Chrysler) will produce more of their small cars abroad? The answer to all three questions is CAFE—the corporate average fuel economy regulations imposed by the federal government.

Under the CAFE (pronounced cafay) law, an auto company producing more than 10,000 cars a year must meet prescribed average fuel economy standards for that year's production of cars, and for its light trucks. The Energy Policy and Conservation Act of 1975 invented the idea, and set standards of 18, 19, and 20 miles per gallon (mpg) for car model years 1978, 1979, and 1980 respectively. (All standards are set for a mixture of urban and highway driving.) The 1975 act also directed the secretary of transportation to set standards for 1981–84, and required every company to attain an average of 27.5 mpg for its "corporate fleet" after 1984. The National Highway Traffic Safety Administration (NHTSA), with Naderite Joan Claybrook at its head, put the standards for the years 1981 through 1984 at 22, 24, 26, and 27 mpg respectively.

David R. Henderson, adjunct research professor at the Naval Postgraduate School, Monterey, California, was senior staff economist for energy policy with the Council of Economic Advisers, 1983–84.

A company that fails to meet the CAFE standard is fined on all the cars it produces in the year in question. The fine per car is $5 for every tenth of a mile per gallon shortfall. Although this sounds small, it is not: if GM, which makes about 4 million cars a year, should fall only one mpg below the standard, it would pay $50 per car, for a total fine of $200 million. Companies can earn fuel-efficiency credits by exceeding the standards for three years in a row, or may borrow on future performance by convincing regulators that they will exceed the standards in any of the next three years. For example, GM and Ford avoided fines in 1983, the first time either of them fell below the standard, by drawing on credits from prior years when they had exceeded it.

In 1984, GM failed to meet the standard once again. And it soon may learn, when the final data are tabulated, that it has exhausted its credits from previous years. If so, GM then must either pay a fine or convince NHTSA that it can offset last year's shortfall by overachieving in the years 1985–87. This answers the first question asked earlier: GM extended production of small, fuel-efficient cars last year because (according to a company spokesman) doing so could save the company as much as $150 million in fines. It also answers the second question. By calling a station wagon a light truck, GM could have raised its average fuel economy on both cars *and* light trucks.

What about the third question? When industry analysts predict more Big Three production of small cars abroad, what they fail to note is that CAFE is calculated separately for do-

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mestic production and imports. If GM imports a small car instead of producing it here, GM's domestic CAFE *falls*. Thus CAFE severely limits the ability of domestic auto makers to produce small cars in joint ventures abroad. According to William Niskanen of the Council of Economic Advisers, former chief economist at Ford, Ford dropped its Fiesta in the late 1970s, not despite, but because of, the car's potentially large market: Ford feared its German-made Fiesta would steal sales from its U.S.-made Escort, thus lowering its domestic CAFE average.

Winners and Losers

CAFE is not the only fuel economy standard the auto companies must contend with. In 1978, as part of the Energy Tax Act, Congress passed a "gas guzzler" tax. This law subjects 1980 and later model-year cars to a special sales tax if they fail to achieve a minimum mileage per gallon. For model year 1985, the gas guzzler tax ranges from $500 on a 20-to-21 mpg car to $2,650 on a less-than-13 mpg car. For model years after 1985 the tax will be $500 on a 21.5-22.5 mpg car and $3,850 on a less-than-12.5 mpg car. So far, the tax has been paid mainly on luxury cars like the Rolls Royce, the Maserati, and some models of the Mercedes-Benz. Presumably, the manufacturers of these cars find it worthwhile to pay the tax because their low sales in the United States do not justify the investment needed to avoid it. (In 1984, for example, only 1,250 new Rolls Royces were sold in the United States.) But the tax has also forced high-volume U.S. manufacturers to downsize or even eliminate their largest models. For example, the average engine size of a large car was 297 cubic inches in 1984 compared with 312 in 1980. The concept of a "gas guzzler" embodied in current law is a strange one. Less than ten years ago, the Pinto was Ford's most fuel-efficient car. Today that Pinto, with an automatic transmission, would be subject to a $500 tax.

CAFE standards and the gas guzzler tax clearly hurt GM and Ford. Both companies have a comparative advantage in producing large cars and face very little competition in that market. Mandatory fuel economy standards prevent them from fully exploiting their advantage, forcing them instead to focus on the small-car market where they are losing out to Japanese producers. Interestingly, though, Chrysler supports CAFE and the gas guzzler tax. The reason: Chrysler has bet its future on small cars. By discontinuing some large cars and downsizing others, Chrysler raised its average fuel economy from 21.7 mpg to 26.1 in just one year (1981). One might think that the CAFE standards and gas guzzler tax would hurt Chrysler by forcing Ford and GM to produce more small cars to compete with Chrysler's. But, because both laws reduce GM's and Ford's production of large cars, the laws also *reduce* the competition Chrysler faces from large car production. Moreover, without CAFE, Ford and GM would sell many high-quality small cars imported from abroad, where they can be produced more cheaply. So, although Chrysler may have to compete with more small cars because of CAFE, Lee Iacocca, its president, must prefer that to competition with both large cars and *higher-quality foreign* small cars.

The support of the United Auto Workers (UAW) for CAFE is also understandable. To be sure, CAFE standards reduce production of large cars and thus reduce employment in large car plants. But if GM and Ford are to make the large cars for which they have a comparative advantage, they must also make a certain number of small cars rather than import them. This means more UAW jobs in small car plants. In fact, Dan Luria, recently a UAW economist, argued for CAFE explicitly on these grounds, stating that "CAFE acts like a domestic content law." One would expect the UAW also to oppose the gas guzzler tax because it discourages production of large cars and thus reduces the number of offsetting small cars that must be made domestically. Sure enough, according to Luria, the UAW wants the gas guzzler tax abolished.

Although CAFE proponents often concede the harm to GM and Ford, many of them claim that CAFE benefits consumers. But the fact is that the standards and the gas guzzler tax hurt almost all car buyers. As economists J. Hayden Boyd and Robert E. Mellman confirmed in a 1980 study of car attributes that consumers value, most American car buyers place a high value on style, performance, and size. CAFE and the tax undercut consumers' ability to satisfy those preferences. Small-car buyers also suffer. CAFE encourages GM and Ford to replace small foreign with small domestic cars for no reason other than to counterbalance do-

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mestic gas guzzlers in the CAFE calculus. If GM and Ford would otherwise import small cars rather than produce them domestically, it is presumably because the imports would be better or cheaper. Some economists have suggested that CAFE helps small-car buyers by lowering prices of small cars. This is not inconceivable, but if CAFE does lower prices, why does Chrysler, which is committed to small-car production, support CAFE so adamantly?

Finally, by giving companies an incentive to make lighter, smaller cars, CAFE also makes cars more dangerous to their occupants. According to safety experts, even if an occupant of a subcompact wears his seat belt, his risk of death or serious injury equals the risk taken by an unbelted occupant of a large car. Not wearing a seat belt doubles his risk.

Why CAFE?

So why was CAFE ever passed? In 1975 American consumers were not paying the true cost of the gasoline they consumed: indeed, the same law that imposed CAFE also extended price controls on oil. Consumers responded rationally—they overconsumed. The legislative options at the time were less regulation (eliminate the price controls) or more (enact CAFE). In 1975, the second option was chosen. Six years later, however, one of President Reagan's first official acts was to abolish the oil price controls and end the subsidy to oil imports. Now consumers pay the true cost of their gasoline and have appropriate incentives to conserve. The original rationale for CAFE no longer exists.

Many CAFE supporters argue that even when consumers pay the world price for gasoline, they do not give appropriate attention to fuel economy when buying cars. But there is evidence that they do. Most European countries and Japan have very high gas prices reflecting stiff excise taxes of over a dollar per gallon. Canada and the United States, in contrast, have relatively low gas taxes and prices. Sure enough, Canadian and U.S. consumers who bought cars before CAFE came into effect favored models with worse gas mileage than those preferred by consumers in Europe and Japan. Moreover, according to a recent study by economists George Daly and Thomas Mayor, when the U.S. price of gasoline rose sharply in the early seventies, and then again in the late seventies, prices of fuel-inefficient cars fell substantially relative to prices of fuel-efficient cars. Thus, by all appearances, consumers *do* take fuel economy into account when they buy cars.

Perhaps, then, consumers need CAFE regulation not because they are unable to assess the value of fuel economy, but because they cannot predict future gasoline prices correctly. The problem is, *no one* can predict future gasoline prices accurately; consumers, in fact, do as well as or better than the government experts. Based on prices of used cars, Daly and Mayor found, for example, that consumers expected real gasoline prices to fall after 1980. The Department of Energy (DOE) on the other hand, together with most energy experts, predicted in 1980 that the real price of unleaded gasoline would reach about $1.80 a gallon in 1984 (in today's dollars). Consumers—not the experts—were right; DOE was off by a staggering *30 percent.* And although DOE predicted further real increases in gasoline prices after 1984, prices are actually falling.

Moreover, consumers can adjust to new information much faster than a government agency. Consumers, after all, make several million purchasing decisions every year, whereas it is scarcely feasible or imaginable for government to confess error or change course more than once in an administration. And sometimes it will not adjust at all: CAFE is a case in point. The Department of Transportation based the 1981–84 CAFE standards on DOE's assumptions about the price of gasoline. The DOE predictions proved as ephemeral as a bad dream, but Transportation still did not change the 1981–84 requirements by even a decimal point.

The last refuge for CAFE supporters is the Club of Rome: we are running out of oil, disaster looms, and we must conserve. But if and when we really *do* run short of oil, that fact will be reflected in the price, and price will supply the right incentive to conserve. One might add that if for some reason oil or gasoline *are* underpriced, a tax on these commodities would readjust the market more efficiently than performance standards placed on cars. Cars, after all, represent only one (among many) sources of demand for oil.

What would happen to fuel economy if we eliminated the CAFE standards and the gas guzzler tax? Not much, some economists have argued, noting that in 1982 an average domestic

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fuel economy of 24.6 mpg was achieved, higher than the 24 mpg then required. Their argument is unpersuasive. More likely, without CAFE, car fuel efficiencies would decline, at least in the short term.

First, the 1982 overachievement must be examined in context. In planning for 1982, U.S. car makers presumably chose models they thought could be sold in future years when CAFE requirements were scheduled to increase. The light truck market gives indirect evidence that 1982 consumers wanted larger and more powerful cars than the auto industry was producing. Even before 1982, sales of light trucks for hauling goods and towing trailers boomed. Cars with large V-8 engines used to accomplish both of these tasks. Second, the price of unleaded gasoline has dropped 15 percent from its 1982 level. This gives consumers still more reason to shift toward less fuel-efficient cars. Finally, Europe in the mid-1970s, with gasoline at about $2 per gallon (1984 dollars), achieved average fuel economy of only about 25 mpg, according to Charles Gray, Jr., and Frank Von Hippel. The United States today, with 40 percent cheaper gas, would be expected to achieve significantly less without CAFE. A reasonable conclusion is that average fuel economy without the standards would be in the low 20s, substantially above the 1973 level of 14.2 mpg but well below the 27.5 level required for 1985.

Benefits and Costs

This sets the stage for addressing—in general terms—CAFE's benefits and costs to the U.S. economy in 1984.

First, the alleged benefits. Without CAFE or the gas guzzler tax, consumers would have incurred higher fuel costs than they in fact did. Cars would, on average, have been bigger and more powerful than those actually produced (under CAFE) in 1984. Now, the average large or mid-size car achieved 20.6 mpg in 1980 and 22.9 mpg in 1984. If we assume that the four-year improvement in gas mileage was entirely due to CAFE, the gasoline saving from CAFE in 1984 works out at forty-nine gallons per downsized car per year. At $1.22 a gallon, this was worth $60. Over the eleven-year life of the car, even assuming pessimistically that real gas prices will rise at the real rate of interest, the fuel economy saving was $700.

But how should we interpret this particular "benefit" from CAFE? Very carefully. Because, to start with, consumers who wished larger cars presumably would have been willing to pay the higher fuel costs. After all, with or without CAFE, no one would ever have been forced to buy a large or mid-size car. Small, fuel-efficient cars were on the market all along.

Another possible CAFE "benefit" derives from the fact that downsized cars cost somewhat less to build. The saving is perhaps $300 a car, considering the slight reduction in the materials required, no significant change in labor needs, and offsetting new costs from added engineering and retooling. But here again, the benefit is illusory. Smaller cars would have remained available without CAFE. Consumers willing to pay the extra costs of the larger cars would (by definition) have valued the increased size at least enough to justify the increased cost. Selling cheap cars to consumers who would prefer to buy expensive ones is not a benefit to anyone.

Finally, what about CAFE's *costs* to U.S. consumers? Here the answer is fairly clear. CAFE lowered the range of market choice available to buyers. Because of CAFE, consumers were forced to buy more light trucks (which use more gas) and smaller cars (which use less gas), and had less opportunity to shop for large cars in the middle of the market. All this for no reason other than to placate the CAFE regulatory police force and its fans.

With the decontrol of gas prices, consumers already pay full price for their gasoline and therefore already have appropriate incentives to conserve. CAFE only hurts consumers by preventing them from buying the kinds of cars they really want. In short, cutting the choices on the menu is no way to run a CAFE. ■

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The Joy of Attorneys' Fees
Grover Rees III
(Continued from page 20)

The fee-shifting statutes generally provide that courts may award "reasonable" fees. It is difficult to say what is meant by this, since the most obvious index of reasonability, the market value of the services in question, is by definition unavailable for lawsuits that the client would not bring if he had to pay his own attorney's fees. The Supreme Court has settled on a formula by which an attorney receives *at least* the prevailing hourly rate for attorneys of similar skill and experience in his community for however many hours he can justify having spent on the case. To this base figure there may be added a "bonus" or "multiplier" (typically 25 to 50 percent of the base) for such factors as the attorney's "exceptional" skill, results "exceptionally" beneficial to the client, or the "degree of contingency," which is the risk that the attorney took that he would lose the case and receive no fee at all. This last provision leads to an odd result: a case that challenged such a gross violation of civil rights that it was sure to win would get only the standard fee, while a farfetched claim that won only by a fluke would get the maximum multiplier for its extreme degree of contingency.

The ideal attorneys' fee formula would provide no more and no less than would have been needed to get some competent attorney to take a given case. On paper, the "prevailing rate plus" formula looks as if it might approximate this ideal. Even the contingency factor can be justified on the basis that it makes public interest litigation just as remunerative in the long run as regular litigation with paying clients (though another way to look at it is that it charges the taxpayers, or whoever else the defendant happens to be, even for the lawsuits that are held to be unmeritorious). But in practice, the Court's formula provides windfalls to lawyers by omitting several key factors.

The first dubious assumption in the formula is based on a distorted view of the economic structure of the legal profession. Although the courts have abolished the minimum fee schedules once promulgated by bar associations and enforced by the threat of expulsion from the legal profession, there is still in most communities an understanding among lawyers that it is permissible to charge far more than the median hourly rate but impermissible to charge much less. The result of the suppression of price competition is that the lawyers whose services are least in demand find themselves unable to attract as much work as they would like to do. Although some lawyers respond by discounting their services, they are most likely to do so on an informal case-by-case basis.

The relative rarity and undetectability of attorney competition below the going rate, together with the unlikelihood that a judge will declare an attorney who has just won a case to be unusually unskillful, ensures that few attorneys will be awarded much less than the median fee award. Recently the Supreme Court upheld awards of $95, $100, and $105 an hour—amounts the Court acknowledged to be at least as high as the generally prevailing rate—to New York Legal Aid Society lawyers who were one, two, and three years out of law school respectively. Moreover, although the "like skill and experience" language does not prevent the median from operating as a floor, it does ensure that the ceiling is elastic. For instance, a federal district court recently awarded Harvard law professor Laurence Tribe $275 an hour for several hundred hours of work—a fee subsequently knocked down to $175 an hour by an appeals court on the grounds that he had charged a paying client less than this amount.

Litigating for Love, Not Money

An even more important flaw in the "prevailing rate" theory is that it ignores the nonmonetary benefits that attract many lawyers to such work in the first place. The decision whether to allocate five hundred hours of your time to a personal injury case, a securities transaction, twenty-five divorces, or a suit on behalf of your most cherished philosophical principles that may lead to a landmark Supreme Court decision is an easy one every time, if somebody will pay you $50,000 no matter which you choose.

For many lawyers the choice would be almost as easy if the public interest lawsuit paid only one-half or one-fourth as much as the less interesting and influential work. Many talented attorneys make essentially this choice by working as salaried employees of organizations whose goals they support even though they could make more money elsewhere. If a big cut

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in attorneys' fees awards were similarly to force self-employed attorneys to choose between material and psychic satisfaction, some would still choose to be full-time public interest lawyers. (To keep things in perspective, even a shockingly large cut in fee awards could still leave them at a figure such as $50 per hour, for what often adds up to several hundred billable hours per case.)

Other lawyers would choose to mix philosophically important litigation with more conventional and lucrative work. Prestigious New York and Washington law firms already choose to do public interest work for social and philosophical reasons. When the law firm wins, it collects from the defendant at rates a bit lower than it usually charges, but far higher than any fee it would actually have charged the plaintiff; when it loses, it spreads the costs among its paying clients. The psychic satisfaction of the attorneys is not without its own palpable economic value to the firm: many firms attract top law school graduates by advertising the number of hours their attorneys spend on public interest litigation.

Paying for goods you would otherwise get for free is not the worst thing in the world; it may well be a prerequisite to generating more goods of the same kind. The problem, however, is that this analysis assumes some sort of rational constraint on how much new litigation will be called forth. Even if something is underproduced by the unaided market, it may still be undesirable to produce too much of it. This may be even more true of litigation than of other good things.

So long as there is an unexhausted supply of attorneys who will derive a greater sum of financial and psychic satisfaction by bringing new civil rights suits than by doing anything else, there will be no *internal* control on the amount of litigation generated by the fee-shifting statute. The number and scope of tax-supported suits against the taxpayers will continue to increase until society runs out of money or lawyers. Congress seems to have assumed that *external* controls—such as a relatively inelastic supply of clients wishing to bring suit, or of constitutional and civil rights, or of arguments that judges might accept—would operate as an effective limit. But this was a naive assumption.

The paradigmatic civil rights lawsuit that Congress had in mind when it passed the Civil Rights Attorneys' Fee Award Act was that of a poor person who had suffered a shocking violation of his civil rights, but who had suffered little or no monetary damage and could therefore anticipate no large award out of which to pay the fee. In an important public interest lawsuit, however, the civil right being asserted is often on the cosmic rather than the individual scale, and the person who happens to be named as the plaintiff may have had very little to do with initiating the suit. Indeed, the selection of a nominal plaintiff is frequently just one of a number of tactical decisions to be made by the lawyers handling the suit.

If anybody other than the lawyers themselves is helping to make the decisions, it is most often a civil rights or public interest organization. Such organizations, like some government agencies but unlike most individual and business litigants, are motivated more by ideological and long-term strategic factors than by a desire to make money. Like the government, they often litigate through salaried staff attorneys whose hourly wage is a small fraction of the "prevailing rate," and they benefit from other economies of scale that result from litigating many cases with similar facts and legal issues. In the award of attorneys' fees, however, these litigating groups get treated not like government agencies but like individual attorneys competing on the open market, which means that they are compensated at an hourly rate much higher than their cost per hour.

Under the prevailing-rate-plus formula, the number of hours a litigant bills tends to approach the maximum number a reasonable attorney could justify spending. By aiming for the upper limit of reasonableness, the public interest organization not only maximizes its receipts in the case at hand but also puts pressure on the ceiling for future cases. In effect, it becomes a cost-plus contractor that maximizes

In effect, [the plaintiff] becomes a cost-plus contractor that maximizes profits by maximizing costs. The system that produces $1,600 socket wrenches at the Pentagon works just as well in producing million-dollar civil rights lawsuits.

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profits by maximizing costs. The system that produces $1,600 socket wrenches at the Pentagon works just as well in producing million-dollar civil rights lawsuits.

Civil rights groups churn the profits from successful litigation back into more litigation. Because of the disparity between what it costs them to litigate a suit and what they are awarded when they win, they need to win only a few suits in order to initiate many new ones. And if they can win the same percentage of this year's cases as they did of last year's, their litigation budget will expand geometrically.

The Rights Industry

This system—essentially an entitlement program for lawyers—has enabled individual rights litigation to grow into a big business. But it poses much more than just a budgetary problem. If the only effect of excessive litigation were to refine the legal system, to call forth ever-smaller incremental steps toward some agreed-on goal of perfect justice, it would be at worst another case of spending too much on a good thing. The problem is that every controversial issue has at least two sides. When a court grants an asserted individual right to one party, it is more often than not rejecting an individual right claimed by another party.

A government making laws and a rights group selecting clients are both faced with a bewildering array of competing claimants. They must consider the putative rights of merchants and consumers, of pregnant women and unborn children, of people who want to swim in the nude at the public beach and parents who do not want their children seeing naked people. When they decide between these claims, or attempt to balance them, they are making political choices between philosophies of government. Thus, most "individual rights" litigants are best understood not as defenders of a generic "individualism" against some other philosophy, but as advocates who happen to promote their own political philosophies in terms of a resulting set of individual rights. In the case of most litigant groups dating back to the 1960s or earlier, the choice of rights coincides with the policy preferences of the left; in the case of a small number of more recent groups, it coincides with the preferences of the right.

The public interest law establishment frequently asserts that its choices among rights are based not on ideology but on the U.S. Constitution. This argument, however, is circular; it is another way to say that professional civil libertarians have come to regard almost all of their political opinions as constitutional rights. As most any candid civil rights lawyer will tell you, few of these rights were contained in the written Constitution that was ratified in 1790 or in its amendments. Rather, they are part of the "living constitution" that has been enacted by the federal courts during the last thirty years. The courts, in turn, have defined the contours of the living constitution largely according to suggestions made by the ACLU and its sister organizations. This is a function partly of the predisposition of most federal judges, but perhaps more importantly of what is called litigation pressure.

The Role of Litigation Pressure

Litigation is not an abstract idea. It is a thing. It has attributes very much like mass, volume, density, speed, and acceleration. Other things being roughly equal, if Position A is urged in a thousand lawsuits and Position B in only ten, the courts will eventually adopt Position A.

Year in and year out lawyers for public interest groups bring thousands of lawsuits urging the courts to incorporate certain ideological positions into the Constitution. These cases are selected from among many more thousands of possible cases for their relatively strong fact situations, appealing plaintiffs, and unappealing defendants. Every effort is made to bring pioneering suits in the judicial districts with the most sympathetic judges, and even then a civil rights organization may be willing to lose many cases in order eventually to win one big one.

When a single federal district judge declares the existence of a new constitutional right, law review articles appear proclaiming the landmark status of the case. In the next round of lawsuits the landmark case and the law review articles are cited as authority. More cases are won. By the time the Supreme Court considers the question, the new civil right is practically an established part of the legal landscape. Even if the justices refuse to go along, a

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public interest group is unlikely to regard its defeat as final. More lawsuits will be brought (with slightly different fact patterns to distinguish them from the Supreme Court's decision) in order to win more victories in lower courts, more law review articles and newspaper editorials, and an eventual reconsideration by the Court.

It is not unreasonable to ask what the state and local governments are doing while their laws and ordinances are gradually being transformed into violations of the Constitution. There are many answers. Some government lawyers lose because they are simply not as competent as the opposing public interest lawyers. Others concede the fundamental claim advanced by the opposition and try to carve out a narrow exception for their clients, either because they are personally sympathetic to the opposing position or because they are more concerned with winning one case than with the eventual progress of the law.

Even when the government decides to fight, it labors under certain disadvantages. Government lawyers, unlike those who work for civil rights or public interest groups, generally take lawsuits as they find them with the plaintiffs, defendants, facts, and judges already selected. It is much harder for hundreds of governmental entities to coordinate litigation strategy —to attempt to ensure, for instance, that the cases that go to the Supreme Court are strong ones for the government and that they are argued by the best attorneys available—than it is for the organizations that bring the suits.

Moreover, once the courts have decided to regard one side of the case as the "individual rights" side and the other as the "government interests" side, a number of procedural and substantive rules combine to make it difficult for the government to prevail—even when the government's interest is in protecting some people from injury by others. Government lawyers themselves contribute to this situation: even when they draw the court's attention to the individual interests that the challenged law protects, they almost always argue only that the Constitution permits the government to protect these interests if it so chooses, and hardly ever that the Constitution requires such protection.

Finally, once the public interest law establishment wins a single case in the Supreme Court it has usually won for good, since government lawyers will generally advise their clients to comply with the decision rather than relitigate what seems to be a lost cause. So the law moves gracefully in the desired direction, riding the crest of the litigation glacier, with only an occasional lurch the other way.

Silencing the Opposition

The effects of litigation pressure might be very different if it came from many different directions at once. But for quite a while the groups litigating for civil and constitutional rights were not at all evenly distributed along the ideological spectrum; nearly all came from the left. During the last few years, however, it seems to have dawned on conservatives that a single defeat in federal court can cancel out many legislative victories. Dozens of litigating organizations have sprung up to press more conservative viewpoints.

If the trend toward diversification among individual rights litigation groups were to continue, the organizations on the left would have to devote substantial resources to relitigating old cases and defending their fundamental assumptions about which individual rights are to be protected, with a corresponding diminution of the resources available for expansion of the constitutional frontiers. This is where Mrs. Black and Dr. Seguin come in. They will serve as an example for others who might think of asserting in court that laws challenged by the established groups should be upheld as valid protections of individual rights.*

*As another example shows, the public interest law establishment is not at all happy about the prospect of sharing with these upstarts the public interest mantle and the strategic advantages that go with it. A recent article in the *Yale Law Journal* suggests that the Internal Revenue Service should deny tax-exempt status to most business-oriented public interest groups. The author, Oliver Houck, ties his proposal to the charge that the groups have received donations from businesses that benefit from the groups' lawsuits. The irony is that, under Houck's plan, these businesses would still be able to deduct their litigation costs as business expenses. The principal effect of denying tax-exempt status would be to deter contributions from people who do *not* have a palpable financial stake in the outcome. In any case, the article implicitly assumes either that contributors to the other kinds of public interest groups get no substantial benefit financially or otherwise from the lawsuits at issue, or that, even if they do, such self-serving contributions (unlike self-serving business contributions) should not compromise the organizations' public interest status.

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Nothing in the Civil Rights Attorneys' Fee Award Act or in any other federal fee-shifting law suggests that such laws should be applied against individuals who intervene to defend their own rights. The law provides that the judge "may" award attorneys' fees to any prevailing party other than the United States. Although the law does not explicitly exclude any alternative—not even the possibility that losing *plaintiffs* might be required to pay attorneys' fees to state and local governments—the courts have construed the statute to deny such awards unless the plaintiff's claim was frivolous. A similar construction on behalf of the intervenors in the Akron case would have been fully consistent with the purposes of the law: to encourage people to assert their rights and to compensate for the advantages governments have over individuals.

In a few cases, such as when a business enterprise is found to have discriminated in employment, the civil rights law clearly permits the awarding of attorneys' fees against non-government defendants. But in these cases it is the wrongful acts of the defendants that the plaintiffs claim to have violated their rights in the first place. When people intervene in a lawsuit to defend the constitutionality of a law, their only offense is to argue in court that their own rights are at least as important as those of the plaintiffs. To treat the assertion of rights in court as if it were itself a civil rights violation contravenes some of our most cherished notions—including those that motivated the passage of the civil rights attorneys' fee law.

To treat the assertion of rights in court as if it were itself a civil rights violation contravenes some of our most cherished notions—including those that motivated the passage of the civil rights attorneys' fee law.

In two earlier abortion cases where the facts were similar to those of the Akron case, federal judges had refused to levy attorneys' fees against parents and other individual intervenors. In effect, the courts treated losing intervenors just as they have always treated losing plaintiffs. The earlier courts had also noted that the presence of individual intervenors had given the courts a more accurate picture of the controversy than if only the government had defended the law. But the Akron judge summarily rejected such reasoning. He noted that the intervenors had caused the plaintiffs' attorneys lots of extra work by choosing to intervene as parties, and that if they had just wanted to suggest helpful arguments to the court they could have done so in an amicus curiae brief. There is a certain tension between these arguments, since the only reason the parties' attorneys do not have to spend much time answering arguments in amicus briefs is that such briefs are notorious for not being read by judges. Moreover, all kinds of parties cause opposing parties' attorneys lots of work year in and year out in all kinds of lawsuits, and only in exceptional circumstances are they hit with attorneys' fees as a result. Those exceptions, as we have seen, sometimes provide that both sets of fees must be paid by an unusually guilty or an unusually powerful party. Even assuming that the ACLU and its clients can be analogized to David, it does not make much sense to designate Mrs. Black and Dr. Seguin as Goliath.

The Akron judge's reasoning presents an unpleasant choice to people who believe a challenged law protects their rights. If they stay out of the lawsuits, they risk losing whatever rights the law affords without ever having had a day in court. Even the most competent government lawyers may not adequately represent the interests of those who are protected by a law, because the state's interests are never precisely identical to those of any one group of citizens. The state will be reluctant to advance arguments that might win a case but cause it to lose some other case or that might make state officials look bad in the eyes of some voters. But if the beneficiaries of the law appear in court to make these arguments for themselves, they now risk bankruptcy.

No such unpleasant choices are imposed on those who choose to challenge a law, even when the only difference between challengers and defenders is that the defenders happened to win the political contest that preceded the judicial one. Mrs. Black and Dr. Seguin, even if they had won their court battle, would not have been able to recover their attorneys' fees from the

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abortion clinics. The asymmetry stems from the court's assumption that anybody who is defending a state law or a local ordinance against constitutional attack cannot really be on the side of individual rights.

The asymmetry stems from the court's assumption that anybody who is defending a state law or a local ordinance against constitutional attack cannot really be on the side of individual rights.

This is a disturbing assumption not only because it reflects a certain cynicism about democracy but also because it tends to be self-validating. The imposition of severe penalties on people who appear in court to defend their own rights under a law will perpetuate the present artificial situation in which the courts see individual rights on only one side of each case, while designating the other side as a mere governmental interest. The presence of flesh-and-blood people on both sides of civil rights cases makes it more awkward for a court to indulge in this legal fiction. Intervenors like those in the Akron case therefore pose a potentially important threat to the hegemony of the current public interest establishment, since the individual rights/governmental interests dichotomy has been crucial to many of the most important victories its constituent organizations have won over the years.

Bad News for Defenders of Laws

Congress is now considering comprehensive legislation to curb the excesses of the federal attorneys' fee industry. One proposal under consideration would effectively overrule the Akron case by making it clear that fees can be awarded only against litigants who are found to have violated someone's rights. Assuming that the Akron case is not overruled by Congress or by a higher court, however, the public interest law movement can be expected to portray it as a landmark and urge its application in other contexts.

The Akron ruling is technically an interpretation only of the Civil Rights Attorney's Fee Award Act of 1976, but its reasoning is equally applicable to many other federal fee-shifting statutes that provide for "reasonable attorneys' fees." The parties at risk in these cases will be people who intervene to defend state and local government conduct; where the federal government is the principal defendant, on the other hand, the language of the usually applicable statute is more precise and harder to apply against intervenors.

Even if the Akron precedent is not applied to any fee-shifting statutes other than the civil rights law, however, it may apply to many private litigants who would not otherwise be forced to pay for their opponents' attorneys. A recent Supreme Court decision has expanded the term "civil rights" beyond its traditional context to mean *any* right secured by the Constitution *or by any federal statute.* Thus the law could be applied to businesses or civic associations who might wish to defend local zoning laws against attack on constitutional or federal statutory grounds, or to hunters and fishermen who support state interpretations of the federal fish and wildlife laws less draconian than those sought by environmentalist groups, or to private schools or teachers who intervene to defend their interest in any of the numerous laws that apply to them, or to anyone who benefits from a state program funded in part by the federal government.

It is even conceivable that the Akron case could come back to haunt the ACLU itself. Some laws, after all, do protect rights that are important to liberals, and conservative lawsuits could place the beneficiaries of such laws in exactly the spot in which the ACLU managed to place Mrs. Black and Dr. Seguin. It is much more likely, however, that attorney fee awards against individual intervenors would prevent right-of-center litigation groups from emerging as serious competitors to the established organizations on the left. In the first place, conservatives have generally been more successful than the left-of-center public interest organizations have been in securing legislative protection for the rights they believe to be important, so that they have more laws to defend and fewer to attack. The left, on the other hand, has done far better in court. Even if new judicial appointments and litigation pressure from conservative groups should eventually reverse the leftward drift of federal judicial decisions, such a

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reversal would necessarily be gradual, and it would start from sets of precedents that define individual rights more or less according to the specifications of the ACLU.

In the first few years of any effort to get the courts to accord constitutional status to the rights they regard as important, conservatives could expect to lose far more cases than they would win. But their only alternative is to confine themselves to defending the power of legislatures to protect these rights, which is what got Dr. Seguin and Mrs. Black into so much trouble in the Akron case. This is quite a discouragement; if during the early history of the ACLU its clients had been routinely exposed to liability for many thousands of dollars in attorneys' fees, it would have had fewer clients.

Finally, the public interest establishment is in a better position than the newcomers to absorb any losses they might incur. The litigation budget of the ACLU alone is many times larger than the combined budgets of all the conservative groups that litigate on "social" issues. The established groups get institutional support not only from blue-chip law firms and large foundations but even, ironically, from various levels of government. In the Akron case, for instance, the ACLU lawyer was also the director of the "litigation clinic" at a state university law school. His services were donated (with out-of-pocket expenses being advanced by the abortion clinics) with the stipulation that the law school and the ACLU would share equally in any attorneys' fee award.

THE FINANCIAL ADVANTAGES that the public interest establishment enjoys over its adversaries, like the fact that it starts out with more of its positions having been designated by the federal courts as the "true" individual rights positions, is attributable in no small part to the fact that it has been on the job longer. In individual rights litigation as in any other market, barriers to entry help the established enterprises. If the costs of setting up business can be made steep enough, competition can be eliminated and monopoly power established. The Akron case—in which a law designed to encourage people to assert their rights in court has been transformed into a bludgeon against the assertion of rights that are not currently fashionable—suggests that the incumbent monopolists are in a predatory mood. ■

Curse of the Mummy's Tomb
(Continued from page 9)

ple, allow the store a generous markup on the merchandise; or it may advertise the item heavily, spurring consumer curiosity and high turnover. Note that manufacturers can win even in cases where a supermarket is a local monopolist; the Soviet Union is known for its rigid retailing monopoly, but finds it advisable to sell Pepsi-Cola anyway.

Rival airlines have a number of ways to bid for prominence in a CRS system. They can create demand from the ground up by advertising aggressively to consumers, or give travel agents higher commissions so as to encourage them to take a moment to call up the extra screens. More drastically, they can launch their own CRS systems, or even market their tickets outside the world of travel agents, as People Express has done. These options were not much explored in the CAB proceedings. The board's statement mentioned, but only to dismiss as an anomaly, People Express's success in selling directly to consumers. They asserted that travel agents would find it hard to switch from one CRS system to another, and they examined only the chance that a new entrant would have of displacing United's SABRE or American's APOLLO—even though carving out a smaller market niche might be a more effective strategy for entry.

The most obvious way for a carrier to bid for better screen position, of course, is to offer a higher fee to the system operator. Thus, the point of the campaign against bias was to demand that the government secure for rival airlines, for free, an increase in listing prominence that they were quite capable of bidding for. One reason for their attitude may be that the fees charged to competing carriers and agents have in many cases been going up, as both the costs of operating the systems and their value to users has risen. Deregulation has intensified the use of CRS systems by making possible rapid fare and schedule changes, entry by new airlines, tighter seat assignment scheduling (because of higher load factors), and more connecting flights (because of the shift toward a "hub-and-spoke" system).

The CAB devoted most of its attention to the question of whether bias is unfair to businesses, and never much looked into the ques-

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tion whether it is harmful to consumers, despite an entreaty from the Federal Trade Commission that it do so. Where the United and American systems are effectively competing with each other, they may be passing along any profits from "bias" by charging lower fees to agents or rival carriers or lower fares to passengers. It is also hard to separate the effects of "bias" from the natural interest of travel agents in gaining quick access to the most popular flights, which often tend to be those of the host airline. The convenience of travel agents, after all, has shaped many aspects of the existing systems; that they exert little effective demand to wipe out any remaining bias suggests that it is not very troublesome to them. Even so, ongoing technical improvements may further reduce the importance of bias by making it easier for users to reprogram their terminals, in effect, so as to influence the order in which flights appear on the screen.

Prominence in a commercial display system is a scarce good. If it is priced at zero, companies will engage in strategic behavior to get it. This can occur even in a seemingly objective ordering scheme; that is why the Yellow Pages, where the listings are alphabetical, has so many companies with names like AA-Aabco. Likewise, the listing of flights in order of takeoff has sometimes led airlines to schedule takeoffs to try to beat each other out by five minutes. There seems to be no way around this fact of life: any display will list some data more prominently than other data, and a directory with an entirely random ordering would defeat one of the purposes of a directory, namely ease of use.

The rules the CAB eventually adopted contained the following provisions:

First, the rules ban both explicit and statistical bias in search routines. Explicit bias is banned in so many words: a CRS system may not use the name of a carrier as a display criterion. The rules restrict the use of many other criteria on grounds of statistical bias, and announce that "indirect" (that is, statistical) discrimination against carriers will not be tolerated. In order to discourage the use of new proxy factors to achieve statistical bias, CRS providers must disclose the criteria that drive their search routines.

Second, the rules ban a number of other industry practices. A host airline may not tell travel agents that it will take away their terminal if they go on booking most of their tickets on that airline the old way or if they install a rival's CRS system. It may not tie agents to contracts of more than five years' duration—which critics warned will make it riskier for an entrepreneur to launch a new CRS system. If it offers enhancement options to one carrier, it must offer them to all. Furthermore, if a CRS vendor carries out market research on the use of its system, it must make the resulting data available to all participating carriers on a "nondiscriminatory" basis.

Third, charges to participating airlines must not be "unfair or discriminatory." By this the CAB means that charges may not take into account the fact that another carrier is a competitor. This rule is "presumed" by the CAB to lead to uniform charges per flight segment for all participating carriers.

Before the ink was dry on the CAB regulations, eleven other airlines filed suit against United and American. Although the CAB did not prove (or claim to be proving) antitrust violations, and although a detailed Justice Department investigation likewise failed to turn up antitrust violations, the plaintiffs are likely to cite the CAB's denunciations of bias as evidence that the CRS vendors have behaved in an anticompetitive way. Moreover, the Senate Commerce Committee has scheduled hearings on whether to require carriers to divest themselves of CRS systems. The telephone experience, however, has left many legislators leery of the Texas Chainsaw approach to enhancing competition.

Other computer data bases have some of the same properties as CRS networks, which raises the uneasy prospect that the CAB rules might open the way to further government regulation of the emerging information economy. Already the publisher of the *Official Airline Guide* has agreed, in an antitrust consent decree, to eliminate "bias" in its directory (which also happens to be available on-line to computer users), and many other software innovations may become "essential" enough to attract regulatory interest. In the "computerized supermarket" of the future, someone's can of peas will have to appear higher on the screen than someone else's. Will screen space—the new equivalent of shelf space—also be parceled out by federal regulation?

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Readings
of particular interest

Regulating the Shirt off America's Back

Import Quotas on Textiles: The Welfare Effects of United States Restrictions on Hong Kong by Morris E. Morkre, Bureau of Economics, Federal Trade Commission, August 1984, 85 pp.

The U.S. government has restrained the import of textiles and apparel for more than twenty-five years, starting in 1957 with quotas on Japanese imports of manufactured cotton goods. Under an international pact known as the Multi-Fiber Agreement, successive administrations have negotiated a series of "voluntary" agreements establishing import quotas for each of many apparel-producing countries. As of 1980 these quota agreements covered imports of cotton, wool, and synthetic fiber products from two dozen countries.

According to this staff report from the Federal Trade Commission's Bureau of Economics, this quota system is costing consumers and the U.S. economy hundreds of millions of dollars a year. The study looks only at imports from Hong Kong because that colony was the largest foreign supplier of textiles to the United States in 1980 (accounting for 22 percent of total imports) and because adequate information on other countries was not available. The author of the study, Morris Morkre, estimates that for 1980 the social cost of quotas on nine apparel products imported from Hong Kong amounted to $308 million.

This cost breaks down into two components. First, the quotas distort consumption patterns. Consumers buy less apparel and more of other goods than would be optimal, and they buy different sorts of apparel. The report estimates the cost of this distortion at $90 million a year.

Consumers buy less apparel than they optimally would for a straightforward reason: the price rises above the cost of production. The shift among categories of apparel is less obvious. A quota on a type of garment—say, sweaters—applies to a garment whether it is plain or fancy, expensive or inexpensive. The quota will raise the price of each sweater by the same dollar figure, say five dollars, so that a $15 sweater will sell for $20 and a $65 sweater will sell for $70. This chokes off demand at the inexpensive end of the market and encourages exporters to shift their output toward more expensive lines of apparel. Similarly, Department of Commerce classifications combine adult with children's wear to make up quota categories (such as men's and boys' cotton trousers), so that exporters produce relatively more adult and less children's clothing. Low-income consumers and large families are harmed more than proportionately by these two effects.

The second and larger cost represents an income transfer from U.S. consumers to Hong Kong producers. The United States allows the government of Hong Kong to administer its textile exports to this country, doling out quotas among its producers. Hong Kong permits manufacturers to engage in open trading in quota rights, which provides an easy way to establish their value to producers. The author calculates their value at more than $218 million a year, with the figure fluctuating according to U.S. demand, Hong Kong production costs, and the level of the import quota. (Although the existence of a quota market is often maligned, and indeed banned in most of the exporting countries, such a market promotes productive efficiency by serving to redistribute quota rights from high-cost to low-cost suppliers, the author says.)

The U.S. government could recapture the value of the quotas from the Hong Kong firms by auctioning them off to the highest bidders. It could also achieve the same effect by imposing a tariff set at a level that produces the same volume of imports as the present policy. In

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either case the monopoly profits from output restrictions would flow into the Treasury instead of foreign hands—although consumers would be no better off, and the annual $90 million consumption distortion cost would continue.

The major benefit usually claimed for the quotas consists of jobs preserved in domestic apparel factories and textile mills, both of which are labor-intensive industries. In 1980, there were more than 1.8 million production workers in those industries. The report estimates, however, that the quotas increased net domestic employment in that year by only 8,900 workers—which means that the social cost of the quotas amounted to $34,500 per job saved. This sum is over and above the annual wage earned by workers in these industries: $7,600 in apparel and $10,700 in textiles.

Another way to look at it is to estimate the adjustment cost for the 8,900 workers who would potentially be displaced by imports. From information about annual wages and duration of joblessness, the author estimates the social cost of this unemployment to be $16.8 million. Accordingly, the ratio of the benefits from removing the quotas to the adjustment costs is $308 million divided by $16.8 million, or eighteen to one.

This benefit-cost ratio is likely to be understated rather than overstated. The reason is that the report estimates the unemployment costs of lifting quotas on South Korea and Taiwan as well as Hong Kong, but estimates the benefits to consumers for the Hong Kong quotas only (data on the other two being lacking). Moreover, both benefits and costs apply to only one year, 1980. If future years were considered as well, the relationship between benefits and costs would be even more one-sided, since the costs of unemployment would end after the workers found new jobs, while the benefits of lower consumer prices would continue year after year.

Textile imports face high tariff rates as well as quotas. In 1980 the tariff rate on all apparel imports averaged 27 percent, compared with only 3 percent for imports generally. Although Morkre believes the tariffs impose substantial costs on consumers and the economy, he does not include these costs in the total, instead estimating the *additional* effects of the quotas. The current Multi-Fiber Agreement expires in 1986, but preparations are already under way for another round of negotiations to prolong import restrictions. Morkre estimates that if 1980 conditions continue to prevail and if future benefits are discounted at 10 percent a year, a highly conservative assumption, then the present value of the net benefit to the U.S. economy of abolishing the import quotas amounts to $3.08 billion.

The Market for Corporate Control: A New Overview

The Modern Corporation: Free Markets vs. Regulation by Nicholas Wolfson (Free Press–Macmillan, 1984), 191 pp.

Some half a century ago, in the famous book *The Modern Corporation and Private Property*, Adolph Berle and Gardiner Means advanced the theory of the separation of ownership from control in the modern corporation: that is, the split between the shareholders of the company and the group of officers and directors who control its day-to-day affairs. Because stockholders are numerous and poorly organized, Berle and Means thought, they are unable to exert genuine control over management.

This view of corporations as mini-states, accountable only to themselves, became immensely popular in later decades, and helped spawn an era of federal and state regulation. The federal Securities and Exchange Commission maintains various kinds of controls intended to defend what are thought to be vulnerable shareholder interests against management exploitation. Many aspects of corporate law have evolved on similar rationales. In this book, Nicholas Wolfson of the University of Connecticut School of Law argues that both theory and regulations were misguided. Recent developments in economic theory, he says, demonstrate that market forces are far more effective than was once thought in inducing corporate officers and directors to work for the interests of shareholders.

One of these developments is the refinement and increasing empirical validation of the "efficient-market hypothesis," which holds that stock prices quickly reflect developing events that affect a corporation. Research indicates

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that management incompetence or dishonesty has an immediate negative impact on the price of the company's stock, and thus on its ability to raise funds for expansion.

The threat of takeover also serves to discipline corporate managements. Stock market prices are closely watched by takeover "raiders" who think they can manage a company's assets better than the incumbent management. Although such acquirers offer current shareholders a large premium over the market price of their stock, research suggests that there is no lasting harm to the stockholders of the "raider" itself—which implies that raiders manage the target corporation's assets better than the former management had done. More crucially, since a badly run corporation is a target for a hostile takeover, incumbent management has a powerful incentive to manage well.

The market for managerial talent itself provides another important form of discipline for corporate officers. Managers compete against each other by cultivating a reputation among their peers and supervisors for efficiency and honesty. The rewards for the winners of this competition include not only present compensation but also the offer of future jobs in other organizations.

Senior managers also tend to be financially interested in the success of their employers through ownership of stock and stock options. In fact, one study found that equity-based rewards to leading executives in fifty of the country's largest manufacturing corporations amounted to more than four times the after-tax income they received from other wages.

Wolfson critically examines longstanding doctrines of corporation law in light of this analysis. For example, he says, market constraints were believed to provide an insufficient incentive for "loyal" behavior by corporate directors. The traditional legal duty of directorial loyalty was meant to serve as a non-market legal constraint to achieve the same end. Perhaps because courts have defined the boundaries of this concept mostly as an expression of their visceral reaction to case-by-case controversies, it has proved extremely difficult to specify or explain.

The author also charges that the Securities and Exchange Commission, of which he is a former staffer, has attempted to override market forces to the detriment of shareholders. In particular, he questions the value and efficiency of the SEC's mandatory disclosure policies. Much of the agency's regulation, he claims, is simply a response to self-interested demand by lawyers; not only are lawyers in private practice a major lobby for new SEC regulation through national and state bar associations, but lawyers also dominate the SEC administrative staff.

One of the principal reforms suggested by the SEC staff, corporate lawyers, and reformers is the appointment of "independent" (nonmanagement) directors. Unfortunately for this view, Wolfson says, the economic literature indicates that the presence or absence of independent directors has no effect on the honesty or efficiency of corporations. In general, he says, nonmarket duties are largely of illusory value in restraining potential managerial misbehavior.

Wolfson concludes that the separation of ownership from control is not a vestige of original corporate sin, but a natural adaptation to economic circumstances. Shareholders, who have capital but not the desire or ability to manage, contract with specialists who lack capital but have the experience and knowledge to organize production. By overestimating the conflict of interest between owners and managers, he charges, the SEC staff and academic watchers of the corporation have created a false dilemma.

A Flaw in Health Care Reform?

"Hospital Readmissions in the Medicare Population" by Gerard F. Anderson and Earl P. Steinberg, in *New England Journal of Medicine*, vol. 311, no. 21 (November 11, 1984), pp. 1349-1353.

The federal government's new "prospective payment" system of Medicare reimbursement could inadvertently create incentives for hospitals and physicians to increase readmission rates, according to this report by Gerard Anderson and Earl Steinberg, both affiliated with Johns Hopkins University. That could lead to more premature hospital discharges and higher program costs, the authors warn.

Anderson and Steinberg examined data on readmissions in the Medicare program before

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the prospective payment system was put into effect. They found that during the period from 1974 to 1978 more than 5 percent of Medicare patients discharged from acute care hospitals were readmitted within five days, 22.5 percent were readmitted within sixty days, and nearly half were readmitted within one year. The cost of these readmissions was quite substantial: the authors project that even if historical readmission rates remained unchanged, the cost of readmissions that occurred within sixty days of discharge may have exceeded $8 billion in 1984. (A readmission tends to cost about as much as the original hospital stay.)

Unfortunately, the authors say, the new prospective payment law could lead to an increase in readmission rates. Since the government pays one price for a given illness regardless of how long a patient stays, hospitals have an incentive to discharge patients as early as possible, even at the risk that a premature discharge will result in a subsequent readmission. Furthermore, the authors believe that the new system's method of measuring output—the diagnosis-related group—does not adequately adjust payments to cover patients with multiple problems. Consequently, they say, a hospital can obtain a financial gain (or at least avoid a financial loss) by "unbundling" multi-problem admissions into multiple admissions.

Both of these factors could increase Medicare reimbursement payments beyond what was originally projected. Although data are not yet available to test their hypothesis, Anderson and Steinberg have developed a benchmark for comparing past with future readmission rates so as to judge the extent of the problem.

Partly in response to such worries, Congress established official peer review organizations to scrutinize, among other things, physicians' decisions on admissions and discharges. These groups might be well advised to monitor readmissions, the authors say, arguing that "even a small decrease in the readmissions rate could result in substantial savings for the Medicare program." A 10-percent reduction in readmissions within sixty days, for example, would have saved $1 billion in 1984. The article identifies several characteristics of patients (such as the reason for Medicare eligibility and whether surgery was performed) and hospitals (such as the number of beds) that correlate with readmission rates. Further study of the characteristics of patients who are readmitted could be used to identify high-risk patient groups for whom increased outpatient supports and better discharge planning might prove to be cost-effective. Such techniques, the authors say, could be important to corporations, unions, health maintenance organizations, and other groups that are concerned with rising health care costs.

The "Misregulated" Networks: Constraint without Competition

Misregulating Television: Network Dominance and the FCC by Stanley M. Besen, Thomas G. Krattenmaker, A. Richard Metzger, Jr., and John R. Woodbury (Chicago, 1984), 202 pp.

Since the 1930s, the logic of economies of scale has made it likely, if not inevitable, that broadcasting stations will be linked together for the simultaneous transmission of the same programs. Today, the three major commercial television networks (ABC, CBS, and NBC) capture the vast majority of television viewers and, together with their affiliated stations, the lion's share of the revenues and profits of the television industry.

Almost from its inception, the Federal Communications Commission has been concerned about the dominance of broadcasting networks (or chains, as they are referred to in the Communications Act of 1934). In 1941, the commission adopted what are called the chain broadcasting rules to regulate the dealings between radio networks and their affiliated stations, and it later extended these rules to television networks. In the early 1970s it added regulations restricting television networks from acquiring a financial interest in programs produced by independent suppliers and limiting the amount of network programming that network affiliates may carry during the heaviest viewing hours.

The adoption of these rules has done little to reduce network dominance. In the late 1970s, each of the television networks supplied almost 100 hours of programming per week to its affiliates, and the stations broadcast more than 90 percent of the network programs made available to them. Moreover, both affiliates and pro-

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gram suppliers complained that the payments they received for carrying or producing network programs were inadequate. In response, the FCC formed a network inquiry special staff to address these complaints and to determine whether new rules were needed to regulate the networks' relationships with affiliates and program suppliers.

This book is an outgrowth of the network inquiry. The authors, who were co-directors and members of the inquiry staff, conclude that past FCC regulation of the television networks has largely been misguided and ineffectual. Moreover, they contend, the problem of network dominance of television is largely of the commission's own making.

Misregulating Television argues that the preeminence of the three major networks is the product of two interrelated FCC policies. First, the current spectrum allocation plan for television, which the FCC adopted in 1952, provides for more than three VHF commercial licensees in only a limited number of markets. Thus, in many markets a fourth network would have no station with which to affiliate, while in others it would have to affiliate with a less attractive UHF station. As a result, the authors say, a fourth over-the-air advertiser-supported network has not developed, and is unlikely to do so, even though the three major networks and their affiliates earn profits that would seem substantial enough to provoke competitive entry in an ordinary industry.

Having made it unlikely that a similarly structured network would emerge to compete with ABC, CBS, and NBC, the FCC compounded the problem by restricting the development of new networks that might use other means of distribution or finance. Thus, during much of the period in which network dominance was a putative concern of the commission, the FCC was maintaining regulatory barriers to the creation of networks that use cable systems to distribute programs or that support themselves through direct viewer payments instead of advertising. It was not until the late 1970s, when strong deregulatory winds were blowing, that the commission removed the most important of these restrictions.

With network dominance thus entrenched, the FCC attempted to limit its effects by adopting a variety of rules designed to make it easier for other program sources to gain access to network-affiliated stations. The authors contend that because these regulations do not deal with the source of network power, they are likely to be at best ineffectual and at worst economically harmful. For example, in the 1940s the FCC issued a rule limiting the number of stations that a single entity could own. The networks responded by entering into an extensive pattern of affiliation agreements with individual stations. Then, after the commission adopted a rule preventing networks from acquiring options on affiliates' time, the networks changed the manner in which they compensated affiliates for carrying network programs, achieving results similar to those that the options were designed to achieve. When the FCC in turn moved to regulate these compensation arrangements, the networks responded by using other devices to encourage affiliates to carry their programs. Throughout these regulatory endeavors the amount of network programming carried by local affiliates continued to grow despite all the commission's attempts to reverse the process.

The authors are especially critical of the prime-time access rule, which bars the networks from filling more than three-and-a-half of the four prime-time evening hours. The rule, they say, confuses constraining the networks with helping the interests of the viewing public. Local stations frequently have to fill the extra half-hour with less attractive programming, and viewers are unlikely to be better off as a result. Another effect of the access rule may have been even more perverse. "The networks may actually have profited from this government-orchestrated joint schedule reduction," the authors write, "because it decreased the inventory of prime-time commercial minutes each had available for sale," in the same way as a cartel would have done.

In the early 1970s, the commission shifted its focus to dealings between the networks and their program suppliers by enacting the financial interest and syndication rules. These rules prevent the networks from acquiring an equity share in programs produced by independent suppliers and from acting as agents (syndicators) in the sale of network programs on a station-by-station basis after their network runs. One of the commission's major (and stated) objectives at the time was to improve the profits of independent program producers. The

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theory was that if producers could make a lot of money selling programs first to the networks and later to stations in the syndication market, they could more often afford to start competing directly with the networks by producing first-run shows for local stations, bypassing the networks entirely.

There are two problems with this analysis, the authors say. First, the rules are unlikely to succeed in shifting profits from networks to program suppliers, since they do nothing to affect the source of whatever market power the networks possess: the fact that there are only three of them. Since networks can no longer acquire rights in independent programs, suppliers must bear more of the risk of program failure than they might otherwise choose to do. (If larger producers are better situated to handle risk than smaller producers, one effect may be to make the program supply industry more concentrated.) Moreover, since a network will place less value on programs when it cannot participate in the profits from their syndication, it will reduce the amount it pays the producer for a show's initial run.

Second, even assuming that the rules do affect the distribution of profits between networks and suppliers, there is no reason to believe that the public will get better viewing fare as a result. If first-run syndication is unprofitable when the profits from sales to networks and reruns are small, it will still be unprofitable when they are large.

The authors argue that networks will always be with us, but that their power to dominate television could be lessened by dismantling FCC barriers to competitive entry. In the last few years, the commission has begun to do that, they say. It has authorized new services such as direct satellite-to-home broadcasting and low-power television, and eased restrictions on over-the-air pay television service. It has eliminated virtually all its program restrictions on cable. And it has allocated more spectrum space to multipoint distribution services in order to promote the development of networks using that technology. In their concluding chapter, the authors set out a comprehensive plan of network regulation designed for an environment without artificial entry barriers in which viewer welfare is the FCC's principal criterion for assessing its rules.

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(Continued from page 3)
plex system of intertwined federal, state, and private interests in the West, and the participants were afraid to risk an unknown new land tenure system. Thus the Reagan administration's public choice economists were unable to design a creative program to move from the existing checkerboard land system to private ownership and proposed, instead, merely to sell off the federal lands as a means to pay off the national debt.

This struck many as absurd—how could that make even a dent in the debt? And among the diverse users of the lands, the privatization initiative also raised fears like those of tenants who are notified that their apartment building is to be turned into condominiums in order to pay off the owner's debt. In such cases the tenant's reaction is to resist.

How much more useful had the administration identified the central problem that makes land use policy in the West so complicated and frustrating: the intermingling of federal, state, and private parcels. A major program aimed at land exchange and consolidation could reduce conflict by giving private and state landowners the opportunity to determine their own land uses responsibly. It might allow us to see how states and private landowners would operate their patrimony. Finally, by simplifying federal land management, it might even make federal ownership more efficient.

Such a move towards increased autonomy would be consonant with other values without reducing the size of the federal estate and would provide a policy framework for shifting land ownership patterns in the future. By failing to grasp the need to design such a policy of transition, the Reagan administration has left the federal estate less amenable to change than before.

John G. Francis,
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ROBERT NELSON responds:

These four letters together capture much of the current diversity of opinion with respect to the future of the public lands. There is probably more basic questioning of the assumptions of public land management today than at any time since the Progressive Era. None of the letter writers disagrees with my diagnosis that the track record indicates a need for major changes, although they have widely differing views on what these changes should be. Nor do any of them deny that any major changes in public land policies will have to overcome a severe case of interest-group gridlock. Indeed, it is precisely because public land management in the past has so often turned into an interest group competition that efficient management has been frustrated.

In its ambivalence, Willey's letter is representative of what I find to be a common current attitude. Willey recognizes the past failures of public land management, but has major qualms about the social desirability of a market outcome. He is not willing to go so far as to advocate privatization but does suggest that, if a new politically sophisticated group of privatization proponents can assemble a sufficient coalition in its support, he would not object strongly.

It is curious that none of the letters comments on what I suggest may be the most likely step—transfer of ordinary federal lands to the states (excluding national parks, wilderness areas, and other areas of special national significance). The states could then serve as laboratories for experiments in privatization or, perhaps, more efficient public management. The lack of comment in the letters may reflect the fact that, as a halfway measure, land transfers to states excite less ideological passion—pro or con. Nevertheless, in the long run, state ownership may be the most suitable tenure for large amounts of ordinary public lands whose highest-value use is dispersed recreation.

The four letters also illustrate the importance of the public lands as a symbol in a broader ideological debate. The public lands attract more attention and generate stronger feelings than their economic importance warrants, because their management is widely seen as a powerful symbolic statement of general social trends. The laissez-faire policies of the United States during the nineteenth century were perhaps nowhere more visible than in the disposal of the public lands. Then, the change to a policy of retention—reflected in the creation of the Forest Service in 1905—helped to determine the character of the Progressive movement. Today, many people seem to assess proposed changes in public land tenure more for their broader ideological significance than for the actual impact on the land. When the stakes are so readily perceived to be the future direction of society, it is no wonder that even small changes are highly controversial. To be sure, the public lands may still be a good mirror, in that they now reflect a society critical of past approaches but somewhat confused and divided about future directions.

Marketing Satellite Slots

TO THE EDITOR:

I agree with Molly Macauley and Paul Portney that market-based allocation of the orbital spectrum would increase efficiency ("Property Rights in Orbit—Slicing the Geostationary Pie," *Regulation*, July/August 1984). My criticism is not of this conclusion but rather of the arguments they use to support it. Idiomatically put, my observations are: First, Macauley and Portney are beating a dead horse, and second, even if the horse were alive, it could not pull the cart they have hitched it to.

Macauley and Portney accuse the Federal Communications Commission of dragging its heels on the auction concept: "So far, however, the commissioners have yet to endorse the sale rather than the rationing of their wares." But many decision makers at the FCC and elsewhere accept such market-based tools of resource management. As far back as 1976, FCC commissioner Glen Robinson recommended the use of auctions to choose among broadcast applicants, in his dissent in the WESH-TV case. The FCC's current chairman, Mark Fowler, has frequently spoken out on the superiority of auctioning over rationing. And several of the other current commissioners have endorsed the sale of radio licenses in various forms. Over the years, a number of congressional leaders have likewise come to support the use of economic choice mechanisms. President Carter also supported the concept in his 1979 press conference statement on communications policy.

Legislation explicitly authorizing reforms of this sort, however, has never passed either house of Congress. Such legislation faces difficult political problems.

Current users whose licenses have scarcity value fear that they will suddenly have to pay high prices for what in some cases they have been getting for free and in other cases they have already paid high prices for (to previous holders). Moreover, even those whose licenses have no scarcity value may fear that a resource use fee could easily become an excise tax. The latter users, moreover, see little need to im-

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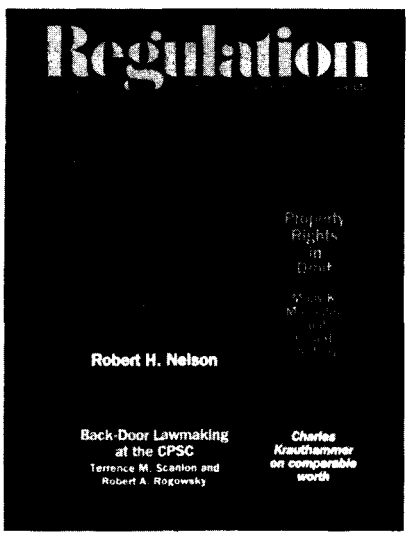
prove the efficiency of spectrum management, since they operate in uncongested regions of the spectrum.

Despite the broad support for a market-based allocation system, it appears that if the FCC held an auction today for satellite parking slots, there would not be enough bidders to raise the price above zero. Macauley and Portney write as though the orbital resource were a scarce one. But they note that, to date, the FCC has not turned away any serious applicants for an orbital slot. The fact is that there is a satellite glut today (the industry calls it a transponder glut). *Communications*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Daily reported on November 16 that more than half of the installed satellite capacity serving the continental United States is inactive.

Moreover, the FCC has adopted a regulatory regime for satellites that is mostly market-driven—and that has enjoyed great success. Although the licensing decision itself is not market-based, the commission places few limits on what users do with their satellite once it is licensed. Licenses are transferable: Southern Pacific sold its satellites to GTE, and Hughes created and marketed a condominium in the sky. A licensed satellite can be used for data, for voice, or for one-way video at the user's option. This flexibility is in strong contrast to the rigid technical restrictions that apply to such services as broadcasting and land mobile radio.

The authors appear to believe that a market-based assignment of initial rights in the geostationary orbit would yield large efficiency gains. They owe the readers some rough estimate of those gains. One way to make such an estimate would be to look at satellites operating under other regulatory systems (those run by the military, other nations, or the Intelsat system, for example) to find technical features which our domestic regulation prohibits. The authors do not do this, and I believe that if they did, they would be hard pressed to find important alternatives that are foreclosed by domestic regulation.

Market-based techniques for spectrum management are important and serve efficiency, but they should not be oversold. Nor should the FCC's solid achievements in regulating communications satellites go unnoticed or unpraised. If regulation always worked as well as it has with the case of satellites, it (the concept, not the magazine) would have a much better reputation.

Charles L. Jackson,
Shooshan & Jackson,
Washington, D.C.

MOLLY MACAULEY and PAUL PORTNEY respond:

We appreciate Charles Jackson's thoughtful letter, but we disagree with him on a number of important points. First, the lack of a satellite slot market cannot be blamed on Congress's failure to pass legislation. More likely it has to do with a lack of chutzpah at the FCC. The Environmental Protection Agency began its now widely accepted emissions trading program without enabling legislation; it was years before Congress finally caught up and okayed the idea. Similar innovations occurred elsewhere in the government without legislation, as when the Department of Transportation experimented with a market for airport landing slots, and the Civil Aeronautics Board sanctioned auctions of airline seats in cases of overbooking. Indeed, the FCC itself has done well in deregulating other areas of telecommunications without waiting for Congress to act. Yet in nearly a year and a half the commission has still not acted on seventy-two applications from telecommunications firms for a handful of slots in the arc. The regulatory workhorse Jackson touts is mired deep in the mud. The FCC must, and just as important, *can* change courses—or should we say horses—even in midstream.

Second, Jackson's comments notwithstanding, we paid explicit attention to the difficulties inherent in the transition to a market, and with this in mind we suggested at least two ways the commission could begin to market slots. Of course incumbents will complain, as we acknowledged, because restraints on access to the arc have let them earn above-average profits. However, such complaints hardly justify maintaining the status quo.

This is precisely why Jackson is wrong in assuming that it is not important that the licensing process be market-based. It is the license itself that confers access to the arc. The Southern Pacific case he mentions illustrates our point. It took a major court battle to decide that GTE could acquire those arc slots when it bought the Southern Pacific subsidiary that owned them. Clearly, those property rights were valuable enough to make it worth going to court. But surely we do not want corporations to have to conduct mergers or takeovers simply in order to acquire slots in the arc.

In assessing the efficiency of the FCC's current regulations, Jackson asks us to compare FCC-regulated communications satellites to those operated by the military or Intelsat, which are not subject to FCC rules. In fact those types of satellites are technically superior to domestic commercial satellites in some respects, but that is not really the point. What we must compare is not one possible inefficiency with another, but the existing regulatory regime with a lively market. We gave examples and estimates of the static efficiency gains from the latter in our article.

Furthermore, the "transponder glut" Jackson refers to may only be a temporary one (see the April 16, 1984, issue of *Broadcasting*), and it is certainly location-specific; there are plenty of slots that no domestic satellite operator would be willing to pay for because the slots do not "see" the United States. This was one of our fundamental observations.

We also cited examples of how regulation has blunted incentives for dynamic efficiency—that is, incentives for companies to do long-term R&D to find ways of economizing on spacing between satellites along the arc. This is an efficiency gain Jackson fails to recognize in his letter.

We repeat the explicit thesis of our original article: only by pricing the geostationary arc—permitting market exchange to decide who gets what—will we elicit these static and dynamic benefits. The FCC should not pass up its opportunity to create such a market. ■

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Broadening the Debate

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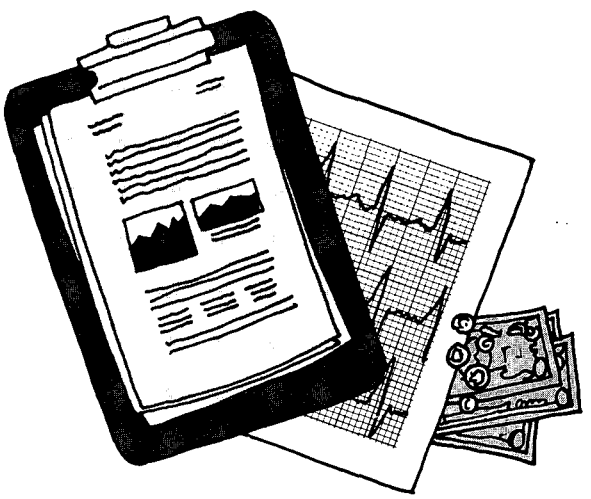

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